ECONOMY, ENERGY AND TOURISM COMMITTEE

Wednesday 27 January 2010

Session 3

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ECONOMY, ENERGY AND TOURISM COMMITTEE
4th 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)

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:

Colin Borland (Post Bank Coalition)
Stephen Boyd (Scottish Trades Union Congress)
Wendy Dunsmore (Unite)
Bryan Johnston (Brewin Dolphin)
Rob MacGregor (Unite)
Brian Scott (Post Bank Coalition)

CLERK TO THE COMMITTEE

Stephen Imrie

SENIOR ASSISTANT CLERK

Katy Orr

ASSISTANT CLERK

Gail Grant

LOCATION

Committee Room 1

Scottish Parliament

Economy, Energy and Tourism Committee

Wednesday 27 January 2010

[THE CONVENER *opened the meeting at 09:31*]

Financial Services Inquiry

The Convener (Iain Smith): Welcome to the fourth meeting in 2010 of the Economy, Energy and Tourism Committee. The main item on today's agenda is our continuing banking and financial services inquiry. We will hear from three panels this morning.

Our first witness is Bryan Johnston, who is divisional director of Brewin Dolphin, one of the United Kingdom's largest independent private client investment managers. The investment and asset management sector is an important part of the banking and financial services sector in Scotland. I welcome Mr Johnston to the meeting and invite him to make some opening remarks, before we move to questions.

Bryan Johnston (Brewin Dolphin): I am just delighted to be here. Good morning.

The Convener: Brewin Dolphin acquired Bell Lawrie about a decade ago. Can you provide the committee with some background on Bell Lawrie and describe any changes in activities that have happened since Brewin Dolphin took it over?

Bryan Johnston: Bell Lawrie has its antecedents back in the 1750s. Originally, the company sold socks and haberdashery to the army. It evolved into an asset management operation primarily as a fundraising exercise during the growth of the railway system and the waterways during the 1850s. It was a founder member of the stock exchange that opened in Edinburgh in 1845. Those are the firm's antecedents.

The more modern entity Bell Lawrie was formed by a merger between three major firms in 1966. I, for my sins, joined in October that year. I left to go to France for a year and came back in 1968. Through a series of evolutions, we ended up as Bell Lawrie Macgregor. Briefly, I was a bank clerk, as we were owned by Lloyds TSB for about three years. It was not an entirely successful period of our development, so we bought ourselves out and linked up with a firm called Brewin Dolphin, which had a similar structure of operation. Brewin Dolphin was primarily a financial adviser to individuals, small charities and pension funds; it also had a fairly vibrant investment banking business to raise money for the corporate sector—mostly private companies.

We merged with Brewin Dolphin in 1993. We hung on to the Bell Lawrie name until March last year, in the belief—rightly—that it was better known than Brewin Dolphin north of the border. Eventually, we decided that it would make sense to run the company with one brand across the UK. We now have 40 offices, the northernmost of which is in Inverness and the southernmost of which is somewhere right down in the south of England, like Penzance. We also have an operation in Belfast.

The Convener: Can you say more about your operation in Scotland? Roughly how many employees do you have? What functions do you carry out in Scotland? Where are your management structures in Scotland located? I am seeking an indication of the nature of the business.

Bryan Johnston: We have an outpost in Inverness, which employs about 15 people, and a small operation in Elgin, with about four. We have offices in Aberdeen, with about 40 people, and Dundee, with about 30. In Edinburgh, we have three divisional activities. Investment managers and investment banking are based in Drumsheugh Gardens, where I work. The back-office facility, which runs many back-office operations for the entire group throughout the country, is based in Princes Street. We have an execution-only operation in George Street, which employs about 120 people. We have an operation in Glasgow, which is primarily investment banking but also has a research facility. We have a small operation in Dumfries, and an operation in Belfast, which we acquired about three or four years ago, and which has about 40 or 50 people. The total number of employees is in the region of 500 or 600 and, throughout the country, the group employs in the region of 2,500.

The Convener: Will you say a bit about the governance structure of the operations in Scotland, for example where they are managed from and how much autonomy you have?

Bryan Johnston: We have a very flat management structure. There is an executive board, which is principally based in London, although an Irishman, who is a great friend of mine, is executive director of investment on the private clients side. Each branch is pretty autonomous. We have our own divisional directing board. Each branch has its own management structure. For example, I am on the Edinburgh management committee. We tend to define and direct our own businesses within our own domiciles. We are very jealous of our local authority and local director for our client base, but equally grateful for the strength of the diverse nature of our business. That applies to most of the operations.

Each office has a head of office and, once every six months, all the heads of office come together for endless committee meetings, when hours are wasted and minutes are taken. We then come back and run the business. The management structure is pretty flat, though.

After discussion and debate, we are allocated a budget from centre, which we then apply ourselves. We run our own money.

Lewis Macdonald (Aberdeen Central) (Lab): I am interested, first of all, in your decision to merge, but I am perhaps especially interested in the decision to abandon the Bell Lawrie brand. One of the issues in the committee's inquiry is whether recent events have damaged Scotland's reputation as a centre for financial services. Was there a particular reason why you abandoned Bell Lawrie rather than Brewin Dolphin? Was it simply a matter of size or were there other considerations?

Bryan Johnston: When we first linked up with Brewin Dolphin, we suggested that we call the whole firm Bell Lawrie. That was discussed quite seriously. However, it was a matter of size and, by that time, Brewin Dolphin had a much larger branch network. When we merged in 1993, we really only had operations in Dumfries and Edinburgh so, at the time, it made more sense to operate as the Bell Lawrie brand up here. The decision to change the name was not an easy one. We are very proud of the Bell Lawrie name, and we recognise its resonance in the marketplace. The decision had nothing to do with what was going on elsewhere in the financial community. With all the traumas in the banking system in Scotland, too little attention is given to the number of jobs that were created prior to the mayhem that developed. Many of those jobs still exist. Although, obviously, the events of the past couple of years are most unfortunate, they are not exclusive to Scotland, to the Royal Bank of Scotland or to HBOS.

Changing the name was difficult. We had to manage it carefully because many of our clients were pretty unhappy about it. They saw Bell Lawrie as a Scottish brand. We believe that the Scottish brand is ourselves—the individuals who manage people's money. That is what we are still trying to do.

Lewis Macdonald: And you have succeeded in persuading your customers about the continuity of the firm, in spite of the change in name.

Bryan Johnston: We normally lose clients for spelling their name wrong, not ours. I am glad to say that business has been growing quite happily before and since the merger.

Rob Gibson (Highlands and Islands) (SNP): Good morning, Mr Johnston. I start by focusing on the impact of the financial crisis on the financial sector in Scotland. From your firm's point of view, what is the impact on your clients?

Bryan Johnston: Long term, most of our private clients are more concerned about the revenue flow that they get from their portfolios than about the absolute capital increase. Of course, it is important to increase the underlying principal, both to offset the effects of inflation and as a natural development of the industry, but the main concern of those clients lies in the income stream—the dividends that they can get. The biggest impact on them is, of course, the loss of income from banking stocks, and dividend cuts elsewhere across the corporate divide.

It has echoes of what happened in 1974. Some of you may remember that a company called Burmah Oil was an integral part of the Scottish economy. Every single investment portfolio run in this country probably had a holding in Burmah. The company went bust, which had a dramatic impact on people's income streams. That is the single biggest effect.

On the issue of confidence, the majority of people with any degree of sophistication recognise that markets ebb and flow, and that there are extremes. We saw the information technology boom reach ridiculous proportions. By 2000, we were buying cat food over the internet. Nothing fundamentally changed. I am quite bullish. Scotland has a vibrant economy financially. We have a recognised asset management industry. Although it sounds bizarre, we have a robust banking system here. Clydesdale Bank is an example of a Scottish bank that is doing extremely well, and there are many other operations. It is clear that we are suffering from the penalties of excess for whatever reason—that will be debated until the end of time—but a gradual readjustment is happening.

As far as my industry is concerned, new asset management groups are opening up all the time. Brooks Macdonald has opened up here and various other companies have come here. I welcome that. I do not regard those operations as competition; rather, they add to the critical mass of Edinburgh and Scotland as a whole.

Rob Gibson: So there are signs of confidence in the fact that new groups are being set up.

Bryan Johnston: Yes. It is recognised that wealth can still be successfully managed from up here. People like the quality of life in Scotland; they may or may not appreciate the quality of life in London. People certainly appreciate the quality of advice that they receive from the various financial institutions up here. That, of course, embraces advice from the insurance companies, which are significant and important, and from the investment and unit trust industries, which are equally important. The Baillie Giffords and Martin Curries of this world are extremely important managers of money and extremely important employers.

Rob Gibson: You are involved in investment banking to some extent. Has restructuring of the investment management sector been needed?

Bryan Johnston: I do not think so. We endeavour to give our clients impartial advice. We must be careful about the divide between investment advice and investment banking. Let us be clear: we are not bankers. An investment bank usually advises companies on how to raise money or improve their balance sheets. Our company is not a lending institution.

Things have been pretty difficult over the past 18 months to two years. For what it is worth, I think that the importance of investment banks will increase, because money is hard to get out of banks at anything like commercial rates at the moment, and companies are increasingly looking to alternative methods of funding. It is clear that one of those methods is applying to their shareholders, whether the company is public or private.

Rob Gibson: People are obviously seeking more advice now, when money is tight.

Bryan Johnston: Yes. Companies and individuals are more concerned about cost constraints at the moment. There were reasonably good sales figures over Christmas for whatever reason, but I think that it may have been an Indian summer and that the reality is about to dawn.

Things are difficult out there for many of my clients, who have seen their incomes contract. That is particularly the case for elderly people, who cannot go back round the course again. I would not say that they are suffering hardship, but they are certainly having to adapt closely to their reduced budgets.

Rob Gibson: How have the low interest rates impacted on the investment sector? Are they encouraging people to look for new forms of investment in order to raise their returns? Is that the driver?

Bryan Johnston: The most immediate impact of low interest rates is on the migration of substantial amounts of money out of the banks and into institutions such as mine. That money will probably not stay there, but one must look elsewhere when one is being paid nothing for a cash deposit in a bank. As a result, there has been a substantial upsurge in the buying of Government and corporate bonds and managed bond funds, but that is drawing to a close to some extent, because we are concerned about inflation. I think that interest rates are likely to start to rise again in the next 12 months. In truth, the base rates of interest at the moment bear no relation at all to the rates at which people can get money out of the banks. All of us—even companies—are talking about 300, 400 or 500 basis points above 0.5 per cent. Savings returns are non-existent—they are 0.1 per cent before tax and inflation. That has been the most obvious impact as far as my business is concerned. Obviously, I hope that some of that money will stay on board and will not migrate back to bank deposits. However, the structure will change. I see a redefinition of asset investment away from fixed-interest assets and more towards quality equities and beyond.

Stuart McMillan (West of Scotland) (SNP): I want to follow up on the line of questioning that has been taken. How has the UK Government handled the financial crisis?

Bryan Johnston: Hindsight is a wonderful thing. It is a bit like the Irishman who, when he was asked for directions, said that he would not start from here. The financial crisis was not UK specific; it was international. One or two countries escaped completely—Australia and Canada, for example, were not really involved. For understandable reasons, the Government was reluctant to get involved at an early stage and become a state owner of financial institutions. A body cannot be the director, architect and controller of financial policy. We are now at that stage, but I do not think that it will last indefinitely. The Government will be extremely keen to get rid of some shareholdings in the Royal Bank of Scotland and Lloyds Banking Group in due course, and it will achieve that.

09:45

Had I been chancellor—which I am not—I would not have reduced interest rates to 0.5 per cent. I think that that encourages individuals to look for alternative methods of achieving profitability, whereas a lot of banking should be rather dull and to do with lending to people who need money and taking from people who do not need money for the time being and paying them a commercial rate. I would have endeavoured to direct the financial emphasis more towards personal taxation, to increase personal allowances and to try to recoup cuts in direct taxation by increased activity in indirect taxation.

Stuart McMillan: We are where we are with Lloyds and the Royal Bank of Scotland, and the European Commission has recently come up with proposals for the future. Was the UK Government right to step into the two institutions to the extent that it did, or should it have taken a different path?

Bryan Johnston: To have taken a different path, of course, would have been to allow what was then HBOS to have gone bust. The implications and consequences of that would have been cataclysmic. When the City of Glasgow Bank went bust in about 1880 or so, there was a disastrous effect on the Glasgow mercantile structure and on individuals.

Do I think that it is right for taxpayers' money to be used to protect taxpayers' money? I suppose that ultimately I do. There is a state responsibility to look after the wellbeing of the state. It is most unfortunate that we got to such a stage. The tensions in the industry should have been spotted beforehand. One has to wonder why questions were not being asked about the state of a loan book that was dependent on wholesale banking, about some of the more extreme lending to property companies, and about the securitising of loans and buying of shares in the companies in question—those are all individual issues. Of course, if the result of every decision was obvious, there would be no need to make the decision. It is easy to blame people when something goes wrong. However, we did go through a period of excess, although it is not for me to say whether it was excessive optimism or greed.

Now that we are here, I think that things will recover. I am quite optimistic that, during the next three or four years, things will begin to calm down and improve. Then, I am afraid, the whole dreary thing will start again.

Stuart McMillan: Can you put your finger on one or two factors that account for the situation that we are in?

Bryan Johnston: I am probably not qualified to say, but I think that the decision to retain interest rates at a very low level for a very long time was a mistake, because it forced lending institutions to look for alternative ways of making returns on cash deposits that, in effect, were lying idle. That encouraged some of the lending that was perhaps ill advised. I would describe it as asset allocation or application by default; money was lent to people without any real interrogation of the risk, in the view that, if they defaulted, the lender would simply acquire the asset, which would appreciate in value. The best example that I can think of is the Florida trailer-park saga in the United States, where it all started; a lot of individuals were being lent money when there was no prospect of their repaying the loan or even keeping up with repayments, and the bankers in question assumed that they would acquire the asset and sell it on at a higher price. I have witnessed four or five property cycles, and eventually property prices go down. In any market there will be the ebbs and flows of demand and supply, however crude that might be.

Stuart McMillan: What do you think will be the consequences for the financial services sector in Scotland?

Bryan Johnston: Are you asking what I think or what I fear?

Stuart McMillan: Both.

Bryan Johnston: What I fear is the usual sound of stable doors slamming behind us as the horse disappears over the hill. Regulation is a major issue for people in the industry, whether we are in banking, insurance, fund management or whatever. At the risk of being a little cynical, I will say that one sometimes feels that regulation is there to protect the regulator and not for the benefit of my clients. We have endless obligations—there is the markets in financial instruments directive, the treating customers fairly agenda, the know your customer regulation and how's your father.

We are now undergoing an enormous exercise in risk analysis. Risk is a variable; it keeps changing. Five years ago, RBS's risk profile as an equity investment was different from its current risk profile. Enron was once regarded as one of the most powerful, risk-free investments in the US stock exchange, and it went bust. The difficulty is in trying to gather up and structure the mercury that is risk. Trying to regulate that so that all my clients are always aware of the risks that they are adopting would be extremely difficult, onerous and expensive. Ultimately, it would not be to the benefit of the community or the individual in question. Risk is risk—but I have a scunner against health and safety as well.

Stuart McMillan: Has any long-term damage been done to the reputation of the financial services sector in Scotland? Do you think that the problems will blow over because they have occurred elsewhere, too?

Bryan Johnston: There is no doubt that what has happened to the banks has been disastrous from a reputational point of view. However, people are not looking back to what the Royal Bank and the Bank of Scotland were when they were fairly small, localised operations. They evolved into multinational operations with international reach. Now, they are having to retrench.

There is not sufficient emphasis on areas such as fund management and insurance, where we have an excellent reputation, and we stand four-square in the world when it comes to quality—the position there is healthy. I have seen no evidence of clients migrating out of my or any other institution because of reputational damage to Scotland, but it is important that we talk up and emphasise the quality of people here, which is generally first class.

Marilyn Livingstone (Kirkcaldy) (Lab): Is it important to have a cross-border approach to regulation?

Bryan Johnston: Do you mean "cross-border" as in England and Scotland—

Marilyn Livingstone: Yes.

Bryan Johnston:—or the UK and the continent?

Marilyn Livingstone: In the UK.

Bryan Johnston: We cannot run an investment market with different regulations. My real concern lies not so much with unilateral regulations in the UK, but with their coming into conflict with Brussels. That needs to be sorted out. I am deeply worried that we will get two-tier Governments with two-tier qualifications so that, eventually, the market will migrate towards Brussels. The European stock markets are, by and large, much less mature and developed than the ones in the UK and America. We are therefore being obliged to walk at the slowest pace. As regards directives, one often feels that an assumption is being made that every financial adviser is a crook and every client a moron. That might be true according to some evidence, but it is not generally accepted.

We must have a level playing field where the client is well looked after and gets responsible and sensible advice, and where the practitioner can function without being completely hobbled by overregulation.

Marilyn Livingstone: Some witnesses who gave us evidence over the past few weeks raised concerns about the idea that a one-size-fits-all approach might be the way forward for the financial sector. Do you have a view on that?

Bryan Johnston: I do not think that one size does fit all. Every individual client of ours has a bespoke requirement that is unique to them. One has a common profile-of-investment approach, but it is extremely important that investment advice is unique to the individual recipient of it. That applies to pension funds, insurance policies and portfolios of shares.

Marilyn Livingstone: You will have heard Lord Myners stating that, unless investors take more responsibility to ensure that changes are made,

"without significant steps forward, the 'ownerless corporations' will sleep-walk into another catastrophe."

What is your view on that statement?

Bryan Johnston: Anybody who buys anything, whether it is a motor car, a bottle of wine or an investment policy, should take advice and should be satisfied that it is impartial and well qualified. I would counsel any individual to do just that.

In my company, there has been a marked migration in my lifetime from advisory investment management to discretionary investment management. The vast majority of our clients are now prepared to give us the day-to-day authority to act on their behalf without prior consultation. We then write, of course, to explain what we have done, and any decision that we take is entirely conditioned by the profile of the client's aspirations, by risk and so on.

That is much the same approach as with buying investment trusts, where people rely on the fund manager to run the product. That is what our clients do. That is not an abdication of responsibility by the client, however. If anything, there is more of an onus on the financial adviser to act responsibly, as he has the authority of taking the pre-emptive investment initiative. I am in favour of that.

Markets are changing. When I started, we got two strings of prices per day, and that was the only time we knew about any market movement. Nowadays, when a client rings up, by the time he or she is through on the phone I will have a real-time portfolio up, with price movements ticking away on the screen. Some people say that there is too much information available, but it certainly makes my life easier.

Christopher Harvie (Mid Scotland and Fife) (SNP): It is interesting that you mention Burmah Oil going bust in the mid-1970s. A little anecdote is that, had it gone totally bust, we would never have had Mrs Thatcher—Denis Thatcher was a major shareholder in Burmah. The company was of course nationalised as a part of what is now BP.

I will go back to that period, which I know a bit about because I wrote a book called "Fool's Gold"—before Gillian Tett did—about North Sea oil. When the committee first interviewed people for the inquiry, we heard from representatives of the Royal Bank of Scotland, which has put a fair bit into exploring investment in renewable energies, in the same way as Scottish banks recovered after the Burmah disaster with their oil expertise. Coming on stream are carbon capture, renewables, the possible effect of carbon capture on renewing North Sea oilfields and the opening of the north-west passage—I talked to students about that at the weekend in Germany, where I still do a bit of work—which presents a new approach to Europe from the far east.

In the 1970s, bankers made themselves expert in the specialised investment requirements of oil. Do such resources still exist today in investment management in Scotland?

Bryan Johnston: Without a doubt. I applaud operations such as Braveheart Ventures and Archangel Informal Investment, which are raising money to allow smaller companies to develop. There is a great deal of expertise; the issue is a shortage of money. Such companies are the life-blood of Scottish companies in particular—we have an honourable history, on which I defer to you. Universities produce interesting ideas, but they might lack the financial or commercial expertise to develop them—that is where professional investors come in.

I am confident that that will be an area for development, but I am also confident that some projects will not work. That is the nature of the animal—people drill for oil, but they do not always find it. The same thing applies to any project. However, we should encourage that entrepreneurial spirit. After all, Scotland was the founding father of the investment trust industry, which it founded by raising money to fund railway development in America. Somewhere out there is another railway of America—I do not know what it will be—that I hope will be funded, in part at least, by the expertise that is in Scotland and the money that is managed in Scotland.

Christopher Harvie: I will elaborate on one aspect. Is the alternative the development that took place in the 1990s and into the noughties—in every sense of that term—when much of that investment expertise was involved with secrecy jurisdictions such as the Cayman Islands, as a centre of hedge-fund management? That took such activity further from responsible control.

Bryan Johnston: I have never fully understood how a hedge fund can be run and how risk can be quantified to the point of exclusion of that risk. Whether a long or short position is taken, risk exists, unless the positions absolutely counterbalance each other, which means no risk but no commercial gain. Any product has a risk.

I am probably not qualified to say so, but concerns are expressed about operations being run from areas that are perhaps less regulated than others are. That goes back to the point about a level playing field for regulation, about which I feel strongly. We should all operate on that basis.

An interesting point is that I have been asked to write a wee article about the golden-share concept. Should we protect some commercial operations in the UK? On the face of it, the proposition is attractive—and in France and Spain, some industries have a golden share and cannot be taken over by foreign investors—but I am against the concept. If a company goes into the public domain, it should stand by that and its shareholders should be entitled to have their management justify the retention of independence.

Regulation is important and I am concerned about some authority migrating to areas that are less regulated and are therefore more open if not to abuse, then to a less structured approach, shall we say.

10:00

Christopher Harvie: If we are to have very large capital projects in the next 20 years, when investment will be scarce, not just the financial architecture but the research and assessment architecture of such projects will have to be thought through carefully. Renewables projects in the North Sea might involve Scottish universities, German technical manufacturers, mass production in China, freighting from China to here and so on.

It seems to me—and I ask for your general opinion on this—that if headquarters are physically located in Scotland, that offers the prospect of continually being in advance of the technical input and knowing what is coming up. We had that advantage to a great extent with North Sea oil—alas, it was squandered—although the actual advantages have never been properly written up. Is there something to be said for some type of European state commercial structure to attract the strategic centre of such massive investment? We are talking about trillions when it comes to the North Sea grid and the various things connected to it. Attracting that centre to Scotland would involve some measure of state-like negotiation, with commercial interests combining with those of the Government. Looking back over the North Sea experience, I think that the Norwegians were the wise virgins in that operation. That example should not necessarily be copied slavishly, but it should be thought of in strategic terms.

Bryan Johnston: I agree with you. I am opposed to nationalisation. The danger of having state funds—perhaps through contributions from various countries—is that the largest contributor controls the destiny of the operation. The Norwegians have scored because of their much more enlightened tax policy. If you explore for oil off the Norwegian shelf, you get a tax write-off against that, which is not the case in the UK. Most of the money that was spent in the North Sea developing the UK's oil fields was, in fact, overseas funding, yet the UK got a large fiscal benefit from that.

You do not require state funding or international state funds on which people can draw. I would rather see a more enlightened fiscal policy, whereby companies or collections of companies or individuals have a tax shelter for five years while they develop operations. That would be much more sensible, because if the operations were developed successfully, the fiscal benefit would accrue thereafter.

Lewis Macdonald: I will take you back to the financial, structural and regulatory issues. You said in answer to a previous question that questions should have been asked about loan books, securitisation and other financial practices within the banking sector. Who should have asked those questions?

Bryan Johnston: I think that we are all culpable. It is easy to point fingers, but the shareholders were pretty supine—many of them did not ask questions about the quality of loan books and so on. However, I am afraid that companies go bust; it is the nature of the beast. For example, spat manufacturers are not doing terribly well at this stage—the cycle of demand can change. Shareholders did not ask questions, perhaps some of the non-executive directors did not ask questions and perhaps some of the executive directors did not ask questions of their own colleagues. We are all publicly culpable.

It was evident what was going on in the banking sector. The Government gleaned vast amounts of taxation from banks and bankers directly and did not appear to question where that revenue was coming from. Shareholders enjoyed the benefits of the rising share price without questioning its long-term sustainability. I am not looking to pick anybody out and say, "It is them; it is their fault." I believe that we are all to blame and are all culpable. We should all learn, but none of us will.

Lewis Macdonald: Is that not the significant point? We all agree that we should all learn, but the question is whether there is the capacity to learn and make a difference. You previously used the characterisation of all bankers being crooks and all clients being morons. You do not need to believe that to believe that the investors were often not properly protected, whether that be by the boards of the banks, the regulators or both. Some of your answers on what happened in the wider banking sector have implied that you do not believe that a tougher regulatory regime is required. Do you think that a different regulatory regime is required?

Bryan Johnston: In the past 10 or 15 years, two things have brought the case home to me. A young couple who came to me were terribly excited, because a bank had offered them a loan of 120 per cent of the value of the property that they wanted to buy. That was a multiple of six of their combined income, but they were incredibly excited. I am afraid that I rather rained on their parade and asked, "What happens if interest rates go up, you lose your job or you get pregnant?" They looked at me blankly, because those questions had never crossed their minds. I should not have been asking those questions; they should have been asking the banker and the banker should have asked them.

When I took out my first mortgage, I took out a low-cost endowment policy, which proved 25 years later to be fairly lucrative. However, those who bought the same product in the 1990s found that it did not repay their loan. I was involved with the Law Society of Scotland in considering many allegations of mis-selling. However, it was not mis-selling; it was a misconception. People were given examples of 4 or 8 per cent growth, but that did not happen, so they ended up with a loan that was not matched by the value of the policy against which it was secured. However, people forgot that the value of property that they had acquired had gone up by a multiple of four—that calculation never came into the debate. There was an allegation that products had been mis-sold. I have no doubt that mis-selling occurred in some circumstances, because in any society where there is money there is a crook, but the vast majority of policies were sold honestly and genuinely, and probably rightly as the right product at the time. That they did not achieve what was expected was a pity.

We do not require more regulation; we require common sense and the more sensible application of the existing regulation.

Lewis Macdonald: I presume that what happened is that people who gave financial advice failed to make clear enough to their clients the level of risk that was attached to products. Is that a general truth about recent years?

Bryan Johnston: There was a supposition of acknowledgement of risk. If you remember, in the 1990s, inflation was running at 8 or 9 per cent, so there was an assumption that the value of products would rise by at least that on a compound basis, which would therefore pay the loan. Ironically, it was the collapse in inflation rates to 1 or 2 per cent that made product growth much more pedestrian. Of course, people still had the loans. I argue that it was not mis-selling and that there was a misconception. The documentation gave strict examples and people could see that growth at 3 per cent would not pay off their loan. I cannot recall whether it said in block capitals that the loan might not be paid off, but I suspect that that probably was not overemphasised, because it never happened.

Lewis Macdonald: That is the critical point, in a sense. The financial adviser is the person who ought to understand and communicate the risk.

Bryan Johnston: That is right. I am a great believer in asking, "What if?" You have to look at any prospect and say, "What if whatever happens?" and then analyse and take account of that contingency. Hence my wee story about that couple. They should have been asked what would happen if interest rates doubled or if they lost their jobs. With hindsight, one can look back and wish that one had asked a question or known something, but it is difficult to know today what questions one should have asked yesterday about the problem that will happen tomorrow.

Lewis Macdonald: I presume that the success of your organisation rests on the quality of advice that you give and your efforts to mitigate risk, or at least to explain it to your clients.

Bryan Johnston: Yes. The client has to be made aware of the fact that if they buy equity, they are at risk. Some companies might not do well and some might even fail, so that risk has to be taken into account. The same applies to people who buy Government bonds. When I started out, war loan was standing at 98 and inflation was running at about 2 per cent. By the late 1970s, inflation was 25 per cent and war loan was at 35, so Government bonds are not necessarily risk free either, and neither is cash.

Lewis Macdonald: So nothing is risk free in that sense.

Bryan Johnston: I am afraid not. Life is a risk.

Lewis Macdonald: Absolutely, but we have heard a lot of evidence that there was a complete failure to account for risk in the decisions of some of our leading financial institutions. That problem clearly starts with those institutions, but the question for us as a parliamentary committee is whether Government or regulators ought to be doing something to ensure that that does not happen to the same degree again.

Bryan Johnston: None of the lending institutions got involved in propositions—whether property lending or anything else—with the certainty that they would lose their money. The assumption was that those propositions would prove profitable in some fashion. As I say, if the result of a decision is obvious, you do not have to make a decision in the first place. However, in my opinion, there was an element of excess that was motivated by avarice and blind optimism. Questions should be asked and the loan risk should be interrogated. In the final examination, there was not sufficient interrogation of the risks that were involved. The "What if?" question was not asked. I do not necessarily blame anyone for that, because those were the times. However, that is what bothers me because, frankly, I think that it will happen again.

Lewis Macdonald: I am interested in exploring that, because we have heard quite a lot of evidence about reforms to the tripartite structure of financial services regulation and fairly broad support for the direction of the reforms. Do you share that view? Do you believe broadly that the reforms will help to mitigate the risk of the situation arising again?

Bryan Johnston: I believe strongly that one institution alone should be responsible for regulating the investment markets, be they insurance markets or whatever, and that is the Bank of England. The Treasury should set the direction of the Government's financial policies and the Bank of England should regulate all that trickles down from that. Self-regulation, with which I was involved originally, and with which the legal world is still involved to some extent, has areas of uncertainty. There should be a regulatory framework that is governed by an authoritative body with executive authority, which to my mind should be the Bank of England. However, I am concerned that we are moving rather rapidly down the road of the US Securities and Exchange Commission, which is almost a terrorist organisation in trying to intimidate people. It is a nice judgment, but I am certainly not capable of working it out. However, there should be a much more clearly defined responsibility for regulation. At the moment, we do not have that.

Lewis Macdonald: You think that that is the key because you are pessimistic about something similar happening in 20 years' time. You think that such responsibility for regulation is critical to reducing the risk of it happening again.

Bryan Johnston: That is my view. The Bank of England is the obvious arbiter of banking, and ergo of markets.

Lewis Macdonald: Why do you believe that the current structure with which we are familiar, whereby the Financial Services Authority takes some of the immediate responsibility for regulating individual institutions, is ineffective?

Bryan Johnston: The Financial Services Authority is an agency apart, as it were, in that it is not directly regulated by anyone. I fear that there would be danger if it became its own autonomous body, slightly decoupled from corrective and central regulation. I would prefer regulation to come from the Bank of England.

Lewis Macdonald: Are there any aspects of the regulation of your sector, as opposed to financial services in general, to which you want to draw our attention, either in terms of where reform is needed or where the regulation of your sector has worked more effectively than the regulation of financial services?

Bryan Johnston: One needs regulation, of course. As I said, my real concern is not so much the existing regulatory structure, but that in an attempt to avoid what has just happened happening again, there will be overregulation to a point where it is almost impossible to function. That is a matter of great concern to me—it is the old adage about red tape. I am worried that we are tied down.

Currently, we are having to go through a reanalysis of our client risk profile. I made the point that with any investment the risk profile can change. The Royal Bank of Scotland's risk status five years ago was different from what it is today.

How do you re-evaluate the risk profile within your client support folio on that basis? However, if I do not do that, I or my firm might be culpable in the event of a disaster. My concern is that the regulation exists to protect the regulator when it goes wrong, not to stop it going wrong in the first place.

Lewis Macdonald: Is there not an element of the regulation existing to protect the wider economy from what can go horribly wrong in your sector?

Bryan Johnston: Of course. As I said, regulation is important. To have no regulation would be absurd, but it is the application of that regulation that is important.

The Convener: On the regulatory framework, have you any comments on the current draft European directives, particularly on the alternative investment fund managers directive and the solvency II directive? Have you any concerns about how those directives might affect your business?

Bryan Johnston: It is important to maintain dialogue—I go back to my comment about the golden share in Europe. We need a universal regulatory playing field. I would like to think that that can be achieved by having a dialogue with our colleagues and peers throughout the continent so that we all operate under the same regulatory framework whether we live in Romania or the Isle of Man. Otherwise, there will be a danger of creating pockets of difference, which would be unfortunate.

Regulation is evolving so quickly at the moment and rules are changing so fast that it is difficult to get a handle on what will happen in reality. For example, President Obama has been talking about breaking up the banks, but I do not see how that will work in practice. If you do that, where do you stop? Do you take my firm and tell us that we cannot act as corporate investment bankers raising money for the corporate sector? We already have Chinese walls. That is where my concerns start to arise.

The Convener: You said earlier that your concern is to get returns for your clients rather than the underlying capital value. One of the causes of the financial crisis seems to have been that the price of assets significantly outstripped their value, particularly in the American housing sector. Do investment managers ever look at the underlying value of assets and think that the market has gone completely awry, or have we ended up with an economy that simply chases price rather than value?

10:15

Bryan Johnston: To put it crudely, I think that most markets usually exaggerate at both ends. Either they get overdepressed—which I think is what happened in 2003—or they go overboard, which is what happened in the technology sector in 2000. These cycles happen all the time. As a fund manager, you have to look at the value of your individual assets. One of the template tests is whether you would buy the stock at a particular price, and if not, why not; and whether in any case the price is still too much. As a great believer in total return, I tend to combine a company's capital potential—in other words, its future earnings growth—with its ability to pay a dividend. As I said before, for most of our clients, their portfolio is a source of income. They are, within reason, not too worried about the principal's ebb and flow; they get pretty depressed when the market collapses around their ears, but get really alarmed when the income flow starts to depreciate.

We certainly do take a view on overpricing assets. Indeed, some of us sold some of our bank shares about 18 months ago—rather too late, it turned out, although fortunately still early enough—and in 2002 it became abundantly clear that the situation in the IT sector was just getting ridiculous. The fact is that whether it be the housing market, the stock market or whatever, most markets eventually self-adjust, and I am afraid to say that when that happens the experience is pretty unpleasant.

The Convener: Is there a danger that because a lot of companies get a return on the price, rather than the value, of the portfolio, and that because some fund managers and those in the banks who manage portfolios rely a bit too much on bonuses, they end up chasing price rather than value?

Bryan Johnston: I wondered when we would get on to bonuses.

The Convener: You might also want to tell us about your bonus structure and how it differs from the situation in the banks and the problems associated with chasing short-term returns and bonuses.

Bryan Johnston: I take the view that a bonus should be just that—a gratuitous payment for exceptional service—and not a given. It is perhaps unfortunate, but we probably got into a culture in which bonuses were geared to the value of the deal in question rather than the amount of endeavour that went into it. However, I have to point out that I am not on the remuneration committee of any company. It is up to such committees, not me, to decide how people are rewarded—and long may that continue.

I have to say, though, that I think it dangerous to curtail arbitrarily the payment of bonuses to people who do exceptionally well. Bonuses are a form of incentivisation and, as such, I am a great believer in them.

As an aside, I am slightly concerned by talk of paying bonuses in company stock. A lot of people took a lot of stock in companies such as Enron and Lehman Brothers and worked for 30 or 40 years reinvesting the rewards they received or their pensions in those shares. When the companies suddenly collapsed, those people lost their jobs, their savings and their prospects. I would not encourage people to overinvest in the company for which they work. It is not a matter of being disloyal—it is just pure common sense.

The Convener: Finally, I have a couple of broader questions on the investment management sector in Scotland. Last week, Steve Smit of State Street told us that he perceived a period of consolidation in the industry. Do you share that view, and if so what would be the implications for employment in Scotland?

Bryan Johnston: I am not quite sure what he meant by consolidation. That would imply merger and integration—

The Convener: I think that that is what he meant.

Bryan Johnston: All I can say is that more and more companies are opening up in Edinburgh all the time. One or two new fund management companies have started up, while others have broken off from other companies to set up on their own. Fund management is a very fluid industry. It is also very personal; after all, these people develop relationships with their clients.

I am very positive and upbeat about the fund management industry in Scotland. We have established teams in Aberdeen, where Rathbone Brothers has also opened up a new office; Inverness, another success story, is very vibrant; and more and more people want their portfolios and pensions run from Scotland.

The Convener: Key to your success is the ability to recruit suitably educated and qualified employees. Is there sufficient stock of such employees in Scotland, and if not what should the Government do to improve the situation?

Bryan Johnston: One of the biggest tragedies of the current economic climate is the impact that it has had on 24 to 27-year-old graduates. Even if you accept that there is an element of fiction in some of them, the CVs that are coming across our desks at the moment are first class. These people are very well educated and were promised that if they did well, went to university and got a degree, jobs would be there for them. However, the jobs are not there. I believe, therefore, that there should be greater emphasis on graduate trainee programmes. Companies should be encouraged to take these people on and, again, I am a great believer in using the fiscal system in that respect. Instead of taxing jobs through higher national insurance, why do we not give companies a credit for employing the young? I should say that my company has a policy of taking on such people, although not as many as I would like. I certainly have no concerns about the quality of education in Scotland—or indeed in the rest of the UK—and that is exemplified by the quality of the graduates that we get.

The Convener: Our inquiry is on the future of Scotland's financial and banking sector. Should Scotland do anything differently to ensure the sector's long-term future or are you satisfied that the current structures are working?

Bryan Johnston: No matter what industry we are talking about, there must be consultation with practitioners. Although many excellent institutions in Edinburgh, Glasgow and the rest of Scotland act as a conduit between the legislative body and practitioners, I feel that there should be even more emphasis on that. Indeed, that is why this committee is excellent. It gives people like me who really have no qualifications to be here the chance to come along and be a bit self-indulgent.

It is clear from what happened in the past that it is very dangerous to make regulation without consultation, so it is terribly important that practitioners are consulted and are at least among the architects of such regulation. After all, we know what we have to do without being cosseted or overprotected.

The Convener: I am sure that you are more qualified to speak on this subject than many members around the table. Thank you for giving us your time and for providing such helpful evidence.

I suspend the meeting for a changeover of witnesses.

10:21

Meeting suspended.

10:23

On resuming—

The Convener: I welcome our second panel. We are moving away from the management side of the financial services industry to the employee side. I am pleased to welcome Stephen Boyd from the Scottish Trades Union Congress, who is a regular visitor to the committee, and Wendy Dunsmore and Rob MacGregor from the union Unite, which has a lot of members in the banking sector in Scotland. I invite you to make opening remarks before we proceed to questions.

Stephen Boyd (Scottish Trades Union Congress): We welcome the opportunity to contribute to what we believe is a very important inquiry. The STUC supports the inquiry because we have been concerned that, despite the plethora of consultative activity that has taken place since the banking crisis and the huge amount of political capital that has been expended, we have seen few signs emerging that meaningful reform has taken place or is about to take place. We have seen little progress towards a reformed banking sector, never mind a reformed economic and social model, which we believe is necessary. There appears to have been little appetite to grasp some of the fundamental issues that have emerged from the crisis. For instance, why are financial markets prone to failure, and why are financial professionals able to benefit from the various market failures that exist in the sector and to extract such extravagant rewards? Real reform is essential.

In our written submission, we outlined a number of the factors that we believe conflated to lay the grounds for the crisis. More than anything, the crisis was precipitated by the failure of the ideas that have underpinned Government policy, business strategy and regulatory regimes over the past 30 years—above all, the naive and self-serving belief that markets, particularly financial markets, are always efficient and self-correcting.

The consequences of the crisis are clear for all to see in Scotland. We have seen the claimant count and unemployment rise by more than 50,000. International Labour Organization-defined unemployment is up by 75,000. Youth unemployment has increased on average by between 70 and 80 per cent throughout Scotland, and by double that in some local authority areas. We have also seen severe falls in gross value added in a number of key industrial sectors. Manufacturing has been hit particularly badly with a fall of about 13 per cent since the start of the recession. The situation is similar for construction. In some key manufacturing sectors, such as chemicals, gross value added has fallen by 25 per cent. The critical mass in some other manufacturing sectors, such as textiles, is really in danger as a result of the crisis. The consequences for Scotland are clear for all to see.

As we make clear in our submission, we believe that, despite the travails that it has been through over the past couple of years, the financial services sector will continue to be a key industrial sector in Scotland. With the appropriate reform, it will continue to provide quality jobs and decent careers for workers in Scotland.

The priorities now have to be to get the Scottish financial sector back to doing what it does best. We have to address the long-term market failures in the sector, which, despite the size and scale of the sector, mean that growing businesses in Scotland very often fail to receive the type of patient, committed capital that they need to grow and to invest in the research and development and innovation in which we would all like to see them invest. That might well open the doors for some state intervention. I have talked to the committee before about the STUC's aspirations for a Scottish investment bank.

Given that the STUC is a trade union movement, in any situation such as this our concerns are first and foremost with the employees who are directly affected, which is why it is great that Wendy Dunsmore and Rob MacGregor are with me today. I hand over to Rob to tell you about the effect on his members.

Rob MacGregor (Unite): On behalf of Unite, I thank the committee for the opportunity to make a submission and to answer any questions that you have. We share many of the STUC's concerns about the future direction of the financial services sector.

The finance and legal sector of Unite is the largest of our industrial sectors. Across the UK as a whole, we have around 150,000 members who work primarily in banks, building societies and insurance companies. Within Scotland, we represent about 22,000 finance sector workers.

It is hard to overstate the impact that the financial crisis has had not just on employment within the sector in Scotland and elsewhere but on the morale of the remaining workforce. It has had a devastating impact. The many certainties that people had about their working life within financial services have been shaken to their very foundations.

10:30

On the history of the financial crisis, it is clear that although a lot has happened, very little materially has changed. In 2009 alone, around 5,000 full-time-equivalent roles in the financial services sector disappeared, and proposed major restructurings have been announced in the two principal banks: the Royal Bank of Scotland and Lloyds Banking Group. However, the industry itself has made little progress on changes to regulation and supervision or attempts to broaden and increase diversity in the delivery of financial services in this country. In fact, the reverse is true. Most notably with the collapse of the Dunfermline Building Society, we have seen greater contraction in and concentration of the very large banks and institutions. Unite wants greater diversity and plurality in the delivery of financial services in Scotland and elsewhere, and more direct involvement in the regulation and supervision of the financial services industry in general. We need an industry that delivers what people want and need, rather than what the banks believe that they should offer.

The Convener: Since you made your written submission in September, RBS and Lloyds Banking Group have made a lot of announcements about future structures. Can you update the committee on the current situation with potential job losses in Scotland and how that compares with the situation in the UK?

Rob MacGregor: We have had numerous announcements from RBS—Wendy Dunsmore will cover those made by Lloyds. The latest announcement that was made as part of the retail network changes was that around 1,000 additional jobs are expected to go. The biggest issue that is likely to affect workers in Scotland is the potential partial break-up of the RBS group as a result of the Competition Commission's inquiries.

On the number of potential job losses across the UK as a whole, at this stage, it is difficult to identify specifically how many jobs in Scotland will be affected. We estimate that a total of around 25,000 workers will be directly affected by the break-up of the two institutions. There will be a significant impact in Scotland. That is not to say that those jobs will necessarily disappear, but they will be directly affected by the proposed changes.

RBS and Lloyds Banking Group have indicated three to five-year restructuring plans, so although a number of announcements were made throughout 2009 that will impact on 2010, we do not know what plans are being made for further down the line. Wendy might want to cover Lloyds Banking Group specifically.

Wendy Dunsmore (Unite): Since September 2009, Lloyds Banking Group has made a lot of announcements. Off the top of my head, I think that it is talking about more than 5,000 job losses UK-wide. Until the restructuring has shaken out, we will not know what the impact will be in Scotland of the Government's intervention and the divestment of the banks. The immediate plan that springs to mind that will affect Scotland is the sale of the Lloyds TSB branch network, which will have a huge impact on staff. Lloyds TSB was feeling just as vulnerable as any other part of the group, but now it knows that it is up for sale, and no communication has gone out to the staff except for an announcement about a four-year plan. Therefore, staff in Scotland are still vulnerable.

The Lloyds insurance section has also been particularly badly hit, as has the back office. We will not know what type of back-office support is needed until we know who buys the section, and if the new owner has its own infrastructure, that will impact on jobs and staff within Lloyds Banking Group.

The Convener: I want to follow up on the divestment of the Lloyds TSB network. The point has been made to me that, had that not been required, the likelihood is that the branch networks in Scotland would have been consolidated. However, because of the requirement to divest the Lloyds TSB network from the HBOS network, consolidation is less likely to happen in the short term.

Wendy Dunsmore: Consolidation will not happen now, because of the divestment—there is no doubt about that. However, consolidation of branch networks does not mean that there will be the same number of staff in one branch and that another branch will lose its staff. Footfall will still be the same or greater, and the amount of work to be done will be the same. There would not have been huge job losses with consolidation; in fact, the company gave a commitment that there would be no job losses.

Rob Gibson: Let us explore the relationship between headquartering and regulation. How important is it to the unions and to your members who work in the banks to see headquarters functions for the banks in Scotland?

Rob MacGregor: It is very important. It is a recognition of the workers' expertise and skill. Head office functions are not necessarily the same as other functions in an organisation; they require specialist skills and expertise that have been developed over a number of years. It is important that we keep such specialist roles where they are, because experience tells us that it is highly likely that, when head office functions are moved, the number of jobs will be reduced rather than increased. We certainly saw that when RBS took over NatWest. RBS stripped out huge numbers of head office roles. It could be argued that one of the problems with NatWest was that there were far too many layers. However, if head office functions were moved from Scotland, we would fear a further process of delayering, to use the employers' parlance. We are therefore very keen to keep the roles where they are.

Rob Gibson: The problem for you is that concentration is likely to take place in certain sectors of the market and that, once RBS and so on are on their feet again, they become a target. Keeping headquarters functions in Scotland is therefore very difficult to achieve in the current financial climate.

Rob MacGregor: Yes, it is, but it is not an insurmountable problem. It is down to demonstrating the attractiveness and the strategic value of keeping head office functions and roles where they are. Most banking operations are very productive and very efficiently run. It is just a shame that not all operations are as efficient and well run as others. Given the right encouragement, the workforce in Scotland, who provide key specialist financial services, is highly motivated and skilled. That situation should be promoted and supported not only by Government agencies and authorities but by the employers. The roles should not be seen as liabilities that can be shed as part of a restructuring process.

Rob Gibson: We have had evidence from UK Financial Investments Ltd, the Office of Fair Trading and the FSA that there was no focus on what the effects might be on the workforce in Scotland or in any other part of the UK of the specific problems that might be created by the depths that the banks sank to. Regulation does not seem to be very smart at all in relation to the banks' workforces.

Rob MacGregor: I do not disagree with that. As we said earlier, a lot has happened but very little has changed. When we look at the regulation and supervision of the finance sector generally, whether in Scotland or elsewhere in the UK, there is very little engagement with employees in the sector or their representatives, although at least 90,000 people in Scotland, and a million more across the rest of the UK, work in financial services. We have a role on the Financial Services Advisory Board, which is very welcome, and we have the opportunity to speak to committees such as this one, but there is very little engagement with employees and their representatives.

The FSA is a case in point. It is responsible for an industry that employs more than a million workers, but although it has a practitioners panel and a consumers panel, it does not have an employees panel. As an organisation, it does not recognise trade unions. Given the various regulatory and supervisory structures that exist in UKFI, the FSA and even the Bank of England, the level of employee representation and consultation on matters that affect the industry directly, rather than on employment issues, is negligible.

Stephen Boyd: It is important to point out that such a state of affairs is not peculiar to the financial services industry. All important regulatory authorities in the UK tend to view stakeholder engagement as a very marginal activity. The boards tend to be peopled by expert interests; we have seen the consequences of that approach to regulation, which is why it features in the outcomes for the better regulation agenda. The experts who sit on the boards take a very narrow view of their remit and often act against wider Government policy and the democratically expressed will of the population. They do not believe that it is important to engage with the workforce in the sectors that they regulate.

Rob Gibson: You make a strong point. I am interested in the discussions about smarter regulation. Do you envisage instituting a role in that for workforces?

Stephen Boyd: Absolutely.

Rob Gibson: Would that role involve extra committees, or would it function within the main structures of the organisations?

Rob MacGregor: As I said, it is about engagement: the regulatory bodies need to engage with employee representatives. I understand the nervousness of some of the regulators that they might stray into matters of employment and employee contracts, but that is not the issue. It is about how the industry is governed, supervised and regulated, and the direct impact that that has on the employees.

It is important to find out where employees believe that regulation and supervision have gone wrong, or have missed a trick. Such problems are ingrained: there are deep-seated problems in retail financial services not only in Scotland, but throughout the UK. We need to ask how employees can be empowered to bring about the type of cultural change that needs to be delivered in the financial services sector.

All those issues need to be subject to wider, thoughtful debate, but that level of engagement is just not happening. Two years into a financial crisis, many analysts and commentators are talking about the need to get back to business as usual, but that is not acceptable.

Rob Gibson: People talk about the need for a regulatory level playing field in Britain and Europe, and beyond—for example, in the G20 countries. Do you see any inkling of hope at a European or G20 level that the interests of the workforces—the people who do the job day in, day out, not the people who made the mistakes that led to the crisis—are being considered?

Rob MacGregor: If they are being considered, it will be as a by-product rather than a direct consequence. We do not hear a lot of talk about the impact on employees. We hear much about the impact on other key stakeholders, and that is right and proper, but even the latest pronouncements from the American Administration are all about the structure of the industry. Although those pronouncements have been welcomed—as they should be—as bold and radical, we are not hearing a lot about the workers.

Lewis Macdonald: As a member of Unite, I am aware of how much work the organisation does to represent people in the financial services sector. I am interested in your and the STUC's perception of the process by which we reached the financial crisis and how it looked from the point of view of people who work in the sector below the most senior level. I was struck by a comment in Unite's submission about how its members, who were on relatively low incomes, were on the front line, dealing with the public perception that all bankers were at it and had made vast sums of money from almost bankrupting the national economy. Will you expand on that and tell us a bit about your members' perceptions of the causes of the crisis and how much management were or were not willing to take responsibility for their own decisions?

10:45

Rob MacGregor: We will concentrate on retail financial services rather than the wider banking sector. Over the past 10 to 15 years, our members have seen an unprecedented drive for retail financial services to deliver higher and higher levels of shareholder value. It was a significant cultural change. The banks have always made money out of retail banking—there is nothing new in selling loans and insurance products—but the drive to increase sales to generate more and more profit was unprecedented. The intention was to deliver record profitability year on year, irrespective of the economic climate and the impact on consumers.

That is exactly what the Royal Bank of Scotland group did. In 1998, the Royal Bank of Scotland made a profit of just under £700 million; the year before the crash, it reported pre-tax profits of in excess of £10 billion; and the following year, it made the biggest loss in UK corporate history. Although retail financial services did not necessarily play a part in that, it happened because of the permanent drive to deliver more and more sales through the setting of unachievable sales targets and the idea of individual performance. That was part of a huge cultural shift. The banks that had large investment arms saw those parts of their businesses delivering unprecedented levels of profitability and tried to replicate in retail banking what they did in investment banking. To be frank, that has been the ruination of the industry. Throughout the UK, despite the economic downturn, we now have unprecedented levels of unsecured and secured personal debt, and the banks cannot abrogate their responsibility for that.

There has been a dramatic cultural shift—I say it was dramatic, but it took place over a number of years—and the important point from our perspective is that nothing has changed since the crisis. There has been a lot of sackcloth and ashes from a number of senior executives in the banking sector but there has been no significant shift in how staff are paid, remunerated, rewarded and managed. That is one of the real problems that we face.

Wendy Dunsmore: The ordinary bank worker about whom Lewis Macdonald asked not only has unachievable targets but is driven by performance management so, if they do not hit the targets, within a short space of time they can lose their livelihood because they can be dismissed. It is extremely important for everyone to understand that. The average salary is about £17,000. People who are on £14,000 or £15,000 a year are driven by their bonuses. Because they are on such low salaries, they need their bonuses to be able to pay the bills at the end of the year. We have to consider the situation from that point of view. We have evidence of colleagues having to take out their own personal loans even though they do not need them, or having to take out credit cards or getting their mums to take out credit cards to hit their unachievable targets. If they do not hit them, the ultimate sanction is dismissal.

There is a huge impact. The targets have not been addressed in the way that they should have been. There are three main factors: the merger of Lloyds TSB and HBOS, which means less competition on the high street; the fall in the industry's reputation, which means that people are less likely to take up financial products; and the recession. All of that has not been taken properly into account. Colleagues still have to meet their targets; if they do not, they face dismissal. In some institutions, they can be dismissed as quickly as six weeks after not meeting their target.

Lewis Macdonald: From your and other witnesses' evidence, it appears that it is the perception of the customer—for example, a small business—that it is harder to access loan finance from their bank but the person at the bank with whom they are dealing is under pressure to deliver a sale.

Wendy Dunsmore: Yes.

Lewis Macdonald: If targets have not changed and yet banks are lending less, then their staff are by definition under greater, rather than reduced, pressure, despite the fact that the customer is finding it harder to access finance.

Wendy Dunsmore: Absolutely.

Lewis Macdonald: The situation has become worse.

Wendy Dunsmore: The job losses that result from people being dismissed under performance management measures are discreet; we hear about 5,500 or 20,000 job losses, but not about people who have been dismissed and who probably will not be replaced.

Lewis Macdonald: What proportion of the bank workforce is subject to that kind of management practice?

Rob MacGregor: All retail service staff are subject to performance management. You would be hard pressed to find anybody who is employed in retail financial services who does not have a target and is not subject to some kind of performance management regime. Situations vary, but they are all variations on a theme.

Wendy Dunsmore: All companies have a distribution curve, which means that there is a percentage of staff at the bottom who are performance managed or performance improved; a percentage who meet requirements; and a percentage who exceed requirements. There are not many people in the last category. Putting people into the bottom category is an ideal way to get rid of staff on the cheap.

Stephen Boyd: The STUC, working with Unite and the Communication Workers Union, recently commissioned Professor Phil Taylor of the University of Strathclyde to do some work on performance management and how it impacts on workers across the economy. We hope that it will be available in April this year.

Lewis Macdonald: That will be very useful. As you say, the issue goes wider than the financial services sector. The public perception of the bankers' bonus and remuneration culture and practice is that it is followed for senior managers and traders. Clearly, there is a gulf between that and the situation that you are describing. Is any of that subject to the collective bargaining that you do on behalf of your members? How can the gap between those who are making enormous sums of money and those who are under pressure simply to pay their bills be closed?

Rob MacGregor: In general, people do not differentiate between retail and investment banking or between the cashiers and clerks who work in bank branches and the investment bankers who work in places like Canary Wharf. People feel that the banking sector is overpopulated by the greedy, the incompetent and the corrupt. As I said, our problem is that the public perceive that cashiers and clerks in bank branches are on fantastic salaries and have bonuses on top of that with which to buy the second home and the Ferrari, which is absolute nonsense. Over the past 10 years, basic pay for retail staff has been significantly pegged back through the application of performance-related pay and other similar systems. I say that as a trade unionist; it could be described as a self-criticism of trade unions. Cashiers and clerks have to participate in schemes that are called bonuses but are simply part of a variable pay system. Those bonuses do not go on fancy holidays but are used to make ends meet.

Wendy Dunsmore alluded to the situation. The average cashier in a bank branch in Scotland will earn about £13,500 to £14,000 a year. That is pretty similar to a cashier's salary just about everywhere else in the UK, with the exception of London, where the salary is slightly—but not much—higher. The maximum bonus or variable pay potential that such staff can achieve will be 10 per cent of salary—I repeat that that is the maximum, and it is not automatically paid. Even if a cashier achieves the maximum—we should bear in mind that sales targets are arbitrarily set, without negotiation or consultation—they will get a top-up of about £1,400 or £1,500 a year, which is usually paid quarterly in arrears. There will never be a move from that position to anything like the position for people who work in investment banking.

When the banks talk about their ability to pay bonuses, they cleverly like to drag their ordinary workers in retail into the discussion about their investment bankers in the City. They say, "We must treat everyone fairly." The reality is that a cashier would have to work for the bank for more than a lifetime if they were ever to dream of earning the level of bonus that is paid to some investment bankers in one year. There is no collective bargaining in investment banking and there is no analysis of pay and remuneration. We do not know what investment bankers are paid or what their target regimes are. They might work for the same company, but they are a million miles from the cashiers.

Lewis Macdonald: You have described a huge lack of transparency at both ends of the spectrum, because the public perception does not encompass the incomes of front-line staff.

Rob MacGregor: That is right, but I do not blame the public for that. There is understandable public dismay about the size of the bank bail-out and the Government intervention at a time when, elsewhere, parts of manufacturing and retail are going to the wall, whether we are talking about Woolworths losing 30,000 retail jobs or the Corus steelworks losing 1,800 workers in the area I am from. At the same time, people see the banks being propped up and investment bankers collecting bonuses. Goldman Sachs recently said that it would cap its bonuses at £1 million a year. It is understandable that people are angry, but most people never see the people in Canary Wharf and in the ivory towers; they see the person who cashes their cheque in their bank branch.

Stephen Boyd: One of our concerns is that the values of investment banking infected not only the retail banking sector but the wider economy. I heard John McFall's evidence to the committee. As usual, he was on top form. He said:

> "The concept of the self-correcting market has gone and the Chicago school is buried."—[*Official Report, Economy, Energy and Tourism Committee*, 6 January 2010; c 2941.]

The implication was that many of the prevailing orthodoxies that underpinned the approach to economic development prior to the crash are dead and gone. If only that were true. There is ample evidence that the efficient markets hypothesis and rational expectations theory have no relevance, but it is unfortunate that a shibboleth that looks as though it will survive is the one according to which performance-related pay works, although there is much evidence to the contrary. In situations of complexity, the quality of decision making is not apparent until the long term, and performance-related pay is hugely detrimental to performance. I hope that in its report the committee will address that issue, which must be tackled throughout the economy.

Lewis Macdonald: If you think that the culture and, indeed, the reputation of investment banking have affected the retail sector in a very negative way, do you support calls for the separation of investment and retail banking? Would such an approach assist in protecting the interests of your members?

11:00

Rob MacGregor: On one level, we support the call for the separation of the two. However, that would not have prevented the collapse of Northern Rock, Bear Stearns and Lehman Brothers. In the absence of greater transparency and better policing and regulation of the sector as a whole, there may have to be a separation. The behaviour and reputation of investment banking have had a serious detrimental effect on the wider industry.

The Convener: I will ask the same question in a slightly different way. Is not the problem at present that the things in which the banks are involved that have been described as having no public good are being underwritten by the Government? Should we not separate out those items that have no public value? If the banks want to trade in such items, they should do so at their own risk—the public should not underwrite that activity.

Rob MacGregor: We would welcome changes that would outlaw proprietary trading. We also fully support the concept of community banking—financial services providing the services that the community and country need and want, rather than those which they are receiving at the moment.

Marilyn Livingstone: Some of your evidence flies in the face of other evidence that we have taken to date, especially from the banks and the retail sector. When we ask them why they located and are staying in Scotland, they say that they have a highly skilled, highly motivated workforce here. I am interested in your social contract and your five key demands. How far down the road are you with those negotiations?

Rob MacGregor: We are still arguing the case. Many of the employers with which we have dealt believe that they have already adopted those policies. We argue that they have not. The policies are intended to bring about the kind of cultural change that needs to take place across the industry. The financial services sector in Scotland and the UK as a whole is vital to our economy—we cannot get away from that. We need a workforce that is properly engaged, properly motivated and, we argue, properly rewarded. The industry must also recognise the role that it plays in society and it must not stand apart from that. It must start the job of rebuilding trust and confidence among consumers, the workforce and the public at large in how banks and insurance companies operate. I argue that we are some way away from that position.

We take every opportunity to raise the issue of the social contract for financial services. Some employers are more prepared to engage than others. Our overarching concern is that many organisations believe that what has happened over the past years is an aberration, and that we can go back to business as usual. That would be a disaster for all of us, whether or not we work in the industry.

Marilyn Livingstone: When we have asked previous witnesses, especially if they are considering restructuring, whether there has been negotiation with the workforce and the trade unions, we have always been told that there has. We would be interested in being kept up to date with how the social contract is developing, so that we can see both sides.

I have some specific questions about training. Unite is represented on both the Financial Services Advisory Board and the jobs taskforce. How is the work of those groups going? Are they taking us in the right direction? What are the key issues for them?

Wendy Dunsmore: I represent Unite on the task force and we are working closely with all the organisations. One of the biggest challenges for the task force has been that the companies that are offloading staff just now, particularly the Royal Bank of Scotland and Lloyds Banking Group, are fair-weather companies that had always been growing and, when they were losing staff, were at a loss as to how to do that. They have never engaged the public sector in how to redeploy colleagues other than in their own way. Unite has worked with both companies to try to redeploy staff internally, but they never looked outside and worked with partnership action for continuing employment, so we have been quite useful in making the right contacts.

It is early days for the task force, but it has made progress and the companies are now listening to outside bodies to help them to redeploy staff externally, if not internally.

Rob MacGregor: To criticise FiSAB, it does not meet often enough: it meets only a couple of times a year. I understand the reasons, which are to do with getting the great and the good together. However, it is a useful vehicle for exchanging information.

My other criticism of FiSAB concerns employee representation. When it publicises itself, it says that it is a unique body that brings together the Government, industry and the unions. Well—it brings one union. I am the sole union representative and, although I do not feel lonely, it sometimes looks that way. It needs to include broader representation.

However, in FiSAB's defence and on the Scottish Government's approach in general, at least we have that engagement. It does not exist anywhere else; there is no comparable body in England and Wales. It is all very well to talk about engagement, but the only other engagement that we have is ad hoc. We have made our views known to the UK Government about that. There are problems with FiSAB's size and effectiveness, but at least it provides an opportunity for engagement. It would be churlish of us not to acknowledge that.

Marilyn Livingstone: Jim Watson, who is the senior director for financial services in Scottish Enterprise, has talked a lot about not considering only the short term in the industry and has said that the reason why companies come to Scotland is our highly skilled workforce. He has talked about how we can take that forward and the establishment of the skills gateway. Are you involved with the gateway and what role does it play? Until we read about it in a press release that we have been given, I had not heard of it.

Rob MacGregor: I have not had any direct involvement, but I think that one of our colleagues in Unite is involved in it. I am more than happy to write to the committee, if that would be helpful.

Marilyn Livingstone: Jim Watson talks about the financial services skills gateway as

"an excellent example of the type of initiative that we all need to support if we are to develop this highly skilled workforce for the future."

It seems to be a Scottish Enterprise initiative. I wondered whether you had any further information, because I had not heard about it.

I have a final question. How can the financial services sector be supported? Considering all its facets—including education, connectivity and the workforce—what key recommendations should the committee make to the Scottish Government?

Rob MacGregor: I argue strongly that we should try to promote diversity within the industry. There is a real danger that there will be greater contraction and consolidation in the number of financial services providers, not only in Scotland but elsewhere in the UK. The Government should do all that it can to promote different ways of delivering financial services in this country. We will rue the day when only one or two big banks provide all financial services in Scotland. One of the great strengths of the Scottish financial services sector has been its diversity. Despite the loss of the Dunfermline Building Society, which was a terrible shame not just for Scotland, but for the mutual sector as a whole, the financial services sector is still fairly vibrant and vital and should be supported.

Stephen Boyd: I would like to make general comments that relate to the two previous questions.

It is important to emphasise that Scotland has been successful in attracting jobs in the financial services industry before and after the crisis. Therefore, it is not appropriate to suggest—as some people have sought to do—that there have been massive failings on the part of the public sector in providing the skills and infrastructure that the industry needs. The public sector is generally quite effective in that regard.

I return to the question about the role of Scottish Enterprise and other agencies in working with the unions and others to promote the industry's interests, and I refer to the comments that I made on regulation. The view that wider stakeholders in any industry should not be engaged in developing and implementing strategies also continues to affect our public bodies. I sit on a number of the industry advisory groups. Some of those work well and some absolutely understand the role for trade unions and the wider community in developing strategies, but others do not really get it.

I must be careful about what I say about Scottish Enterprise, as my boss is now on its board, but we still have problems with it. Scottish Enterprise board appointments were made this week. One person who was appointed is a long-standing colleague of mine for whom I have the greatest respect, but there is still no woman on that board. The financial sector dominates interests on it, and it does not in any way reflect the wider constituency of the Scottish economy, so it is important that moves be made in that regard. We must build into the culture of Scottish Enterprise, and Skills Development Scotland in particular, the idea that the workforce is a key partner and that it has something to offer that employers do not, particularly with respect to skills development. We are making inroads and some teams are very good in that respect, but that culture is some distance from infecting the whole of Scottish Enterprise.

Marilyn Livingstone: I hope that we will consider the reformed Scottish Enterprise in our work programme. I am particularly keen on considering Skills Development Scotland's role and contribution. I hope that we will have an in-depth look at such matters in a different context.

Stephen Boyd: The STUC did not support splitting Skills Development Scotland from Scottish Enterprise, but we are where we are. I emphasise that Scottish Enterprise is working well in many respects. Skills Development Scotland has been through a particularly difficult transition process, but elements of it are now working well. I stress that I work with colleagues from both organisations daily and that many people in them are doing a good job, but there is a distance to go on wider cultural change.

The Convener: I return to FiSAB. Given that there are to be divestments of some of the existing banks, is there an opportunity for Scotland to shape the banking sector here rather than simply leaving it to the market to decide what happens? Rather than simply end up with whatever we get, should FiSAB take the lead in developing a strategy for producing the banking and financial sector that we want in Scotland and trying to attract businesses to come into that model?

Rob MacGregor: Some body should certainly take the lead, whether that is FiSAB or another body. On simply leaving it to the industry to determine the shape of the sector, we have seen the disaster that we got into. I do not know whether FiSAB alone should determine the structure of the financial services sector—I will leave that to others to resolve—but there must be engagement with all stakeholders on the kind of industry that we will have, the break-up of Lloyds and the Royal Bank of Scotland group, and the potential new players in the market. That will provide us with a unique opportunity to learn the lessons of the past and to build—I hope—something better in the future.

Stephen Boyd: There was before the crisis a culture that still persists, which says that it is not good form to criticise the Scottish financial services industry because it is such an important industry for Scotland. However, we have always argued that the industry has singularly failed in some respects—I will go back to my favourite hobby-horse in that regard. Although companies still have difficulties in accessing finance because of the problems in the sector, there is a longer-term market failure whereby the Scottish financial services industry, despite its size and power, fails to support the type of economic development that Governments of all persuasions have proposed for a number of years through various economic strategies. We want companies to invest more in research and development and innovation, but we have a financial sector that does not support that type of development. Despite the size and scale of our banks, they do very little to support that type of investment. That situation stands in stark contrast to banks on the continent, which have in their economies a long-standing role of providing that type of support to companies.

11:15

Ms Wendy Alexander (Paisley North) (Lab): I declare an interest as a member of Unite. Notwithstanding that, Unite provides an interesting perspective that we have not heard at the committee. I want to work back from the issues that have been touched on so far, the last of which was competition and consolidation in the industry.

It was clear from the pretty impressive evidence that we had from the European Commission that, although it has a locus in competition in the UK as a whole, it does not feel that it is appropriate for it to pursue issues of competition in the Scottish market, because it sees those as domestic issues. In that context, despite the fact that, at the time of the Lloyds TSB takeover, the Secretary of State for Business, Innovation and Skills, Lord Mandelson, instructed the OFT to keep the levels of competition in the personal account, mortgage account and business banking account markets under review, the OFT made clear to us—somewhat depressingly—that it had no work of any kind under way in the UK on consolidation in business banking. It had a little bit of work under way in the other areas, but none in a specifically Scottish context. I think that the committee will take that up in its report, but it might be helpful for Unite to raise the issue through FiSAB, as it moves towards trying to develop a financial services strategy for Scotland. The STUC, in the context of the six business organisations, and Unite could co-operate on issues such as infrastructure investment, which seems to be another appropriate area for the committee.

The divestment of Lloyds TSB branches in Scotland cannot be expected to deal significantly with a 70 per cent concentration of the provision of business banking services in Scotland. Concentration levels of that kind demand on-going review.

I will pause there and just see whether anyone wants to add anything. However, as I said, the level of competition is an area that the committee is likely to take up. It seems to me that both FiSAB and Scottish business-partner stakeholder interests have a locus in that, too.

Rob MacGregor: I would not disagree with that. The level of competition is a major concern. I was at a number of meetings with banks at which they talked about the crisis and its impact on competition. A comment that they made more than once was that there are always upsides to the crisis, in that the crisis killed off or knocked out a number of their competitors. That was certainly the case for smaller providers, particularly when there were problems with funding businesses from wholesale funding.

I agree that there is a real danger that we are going to be left with a group of very big players. There is still concern about that, despite the Competition Commission ruling on the size of the Lloyds TSB banking group, not just in Scotland but across the UK, because it has 30 million current account holders—it is a huge operation. We do not yet know the impact that that will have on the wider retail services industry going forward.

In the context of competition, we remain concerned about the state of the mutual sector. I am sorry to harp on about the Dunfermline, but that was a big loss for the mutual sector, because it was the biggest building society in Scotland. We now have only about 52 mutual building societies across the UK. The reports that we get suggest that 2010 will be a tough year for those organisations. We want all arms of Government—in Scotland and elsewhere—to promote not just mutuality but greater diversity, so that there is not overconcentration in one or two large institutions.

Stephen Boyd: I agree with everything that Rob MacGregor said. It is important to emphasise that the competitive mechanism has not worked particularly well at any level in the financial sector. In essence, investment banking has operated as an oligopoly. Investment banks managed to extract nearly £300 million in fees from the Cadbury deal last week. If a competitive mechanism was working in the system, how could they sustain such levels of charging? Even in retail banking, problems to do with asymmetry of information and opacity of charging structures mean that talk about competition does not give the full picture, although that does not stop us striving to create as competitive as possible an environment.

Ms Alexander: It seems right that the OFT should at least be asked to embark on market structure studies, but such requests have not yet been made.

Rob MacGregor talked about the disconnect between the sackcloth-and-ashes comments of some leading banking players and the reality on the ground. A couple of weeks ago, when Stephen Hester of RBS gave evidence to the Treasury Committee, he said that banking was "a mature industry" that should expect "single digit growth rates." The observation that expectations of returns were misaligned and should perhaps be in single and not double digits was welcome, but seems difficult to reconcile with your evidence, which is that there has been little change in the incentive structures that took the bank from profits of less than £1 billion to £10 billion in a decade and then, in the following year, to the largest corporate bust in British banking history. The lack of change in internal performance and incentive mechanisms is worrying, given public professions about serious changes in approach and expectations of returns.

Rob MacGregor: The banks simply are not changing. In the past few days the chief executive of Barclays Bank denounced President Obama's proposal—consider the appalling temerity of that, bearing it in mind that the head of investment banking at Barclays Capital has been paid £80 million over the past four years. The banks have defended their bonus and remuneration structures. As I said, they are keen to lump everyone in together and to suggest that by defending bonuses and remuneration in investment banking they are somehow standing up for their clerks and cashiers in the branches, which really is patent nonsense.

There have been a number of pantomime villains throughout the crisis, such as Sir Fred Goodwin, Adam Applegarth and Andy Hornby, who were at RBS, Northern Rock and HBOS respectively, but the vast majority of people who were directly involved in the financial crisis are still very much in situ. The idea that we can bring about the changes in remuneration and reward practices and the structural changes to the industry that we need is nonsense; that is not going to happen.

We hear time and again that things are getting back to normal, as though behaviour pre-2007—how the industry approached the market, sold its products and approached regulation and so on—was normal business practice. Pre-2007, I went to meetings at which industry representatives treated FSA representatives with thinly veiled contempt when the FSA talked about treating customers fairly. Now the industry has to be a bit more careful about what it says and how it engages, and the FSA is being far more robust. I do not think that we are fooled by that. Banks want to get back to an environment in which regulation, although it might appear robust, remains light touch and does not directly interfere with their ability to be innovative and produce new and wonderful financial products to sell around the world. The danger that we face is that we will be here in a few years' time talking about the next financial crisis. The question is whether there will be political support for a financial bail-out of the industry, as there was in 2008, or whether we will take the view of the Icelandic people and say, "No. We are not voting for that, thank you very much."

Wendy Dunsmore: We represent the people in the retail branch network. RBS and Lloyds Banking Group have looked at the remuneration of staff in their investment banking arms and those people are being rewarded as the company sees fit. The pension schemes for our members are being squashed—they are being annihilated and people are not getting a final salary pension. Even though they have paid into a final salary scheme for a number of years, it has now gone and staff will not get the pensions that they were promised. Staff are taking a hit on their terms and conditions to finance the companies' restructuring of their remuneration systems.

Ms Alexander: One of the problems for regulators is the absence of transparency within companies, and one of the arguments for compelling structural change is to try to bring about greater transparency.

I return to the question that Rob Gibson asked. The committee is struggling to establish whether or not functions are drifting south of the border. Some people say that the drift of decision making in RBS happened at the time of the NatWest takeover. Notwithstanding the attractive headquarters at Gogarburn, the drift happened anyway. People say that changing a lot of the senior management and almost all the board of RBS, means a material shift south of both decision making and headquarters functions.

On the other hand, people say that HBOS moved to Halifax and London when the Bank of Scotland and Halifax merged and that the subsequent move to a management structure led by Lloyds Banking Group in London meant that there was no material drift of decision-making functions from Scotland and that Lloyds Banking Group's decision making is immensely more centralised than that of HBOS ever was.

Could you share your perspective on that issue with us? We are struggling to establish which scenario applies.

Rob MacGregor: Wendy Dunsmore will cover Lloyds. We share your concerns. In terms of strategic direction, the Royal Bank of Scotland remains very much a Scotland-centred institution. Bearing it in mind that it is a huge, multifaceted organisation, we are not aware of any strategic attempt to move key areas of the management of functions from Gogarburn, for the sake of argument, to other parts of the company. RBS recognised early on that it made a key mistake with NatWest in trying to move a lot of the strategic functions very quickly from London up to Edinburgh. We must bear it in mind that large parts of its business were in England and Wales, so some of the strategic management is still in London, but I do not see an overconcentration of such management. From an industrial relations point of view, we predominantly meet in Edinburgh. We have meetings in London, but it remains the case that the seat of power, shall we say, is very much Gogarburn. I do not know whether that will continue to be the case. As the new management team comes into play and decides how the business will be structured, it might take a different view. At this time, however, I see RBS as a Scottish-centred institution and we are very keen for that to remain the case.

11:30

Wendy Dunsmore: Wendy Alexander is right that it is a merger too late to talk about drift in Lloyds Banking Group. There is no doubt that the HBOS retail side and network were run from Halifax; the corporate arm was run between New Uberior house in Edinburgh, and London. That has changed slightly: there are no longer any flights to Halifax on a Monday; they are all going down to the City. A lot of work is being done. The Mound is a prestigious and important area and the insurance section of Lloyds Banking Group, led by Archie Kane, now resides there as the Scottish headquarters of Lloyds, but it is a merger too late to talk about drift, because it happened in 2002.

There is now an emphasis in the corporate sector on returning to Scotland because of the difficulties with employing people in London, where there are more jobs than people. However, the drift back is minute in the scheme of things. The fact that the Lloyds Banking Group will recreate the Bank of Scotland brand in a meaningful manner brings the Scottish element back.

Ms Alexander: I have a final question on a totally different topic: the industrial relations climate in the industry. In a crisis, workers are all the keener to be unionised, organised and represented through the collective bargaining processes. Similarly, in periods of profound economic stress, employers often become more hostile to organisation by employees and workers. Has it been possible to recruit members in the current climate? Has the union's strength in trying to lobby for the preservation of final salary pension schemes, for example, increased or is the economic pressure on the sector so overwhelming that it undermines the power of organisation in the workforce? Some observations would be helpful.

Rob MacGregor: It is a combination of the two. There has been a net increase in membership in the finance sector. Over the past 18 months—a time of significant job losses—our membership has grown by about 9,000. People have recognised that, if there was ever a time to be a member of a union, it is now. By the same token, there has been a huge increase in the level of industrial activity, particularly in Lloyds Banking

Group, where Wendy Dunsmore is in and out of meetings almost every day with consultations on restructuring.

A number of employers have attempted to use and abuse the financial crisis as an excuse to keep wages at historically low levels. Any pay increases are very modest and, in some cases, fly in the face of the company's performance at the time. In the wider context, they have regarded it as an opportunity to have a go at the sacred cows of terms and conditions, such as the few remaining final salary pension schemes, and there have been a number of fairly high profile industrial bust-ups over that.

By and large, we have working relationships with the industry where we are recognised. I would put it no more strongly than that. We continue to deal with a range of industrial relations issues as time goes on and I do not foresee any change in that in 2010. Over about the past 20 years there was a steady improvement in the overall terms and conditions in the industry, but that trend plateaued a few years ago and is now on the slide. The new generations of finance sector workers have poorer terms and conditions of employment, partly as a direct consequence of the crisis.

Wendy Dunsmore: Unite has been trying to campaign over the past number of months, particularly from the launch of our social contract, to end the bonus culture in Lloyds Banking Group because it does not give anybody fair pay. It is skewed by investment banking. Lloyds Banking Group does not go out and say that Jeannie from Auchtermuchty gets £2 in a bonus but Johnny down in London gets £2 million; it comes out with a pot. The newspapers do the maths, divide the pot by the 142,000 employees in Lloyds Banking Group and Jeannie from Auchtermuchty suddenly gets £40,000. We are trying to end the bonus culture, because it is so detrimental and so bad for morale. We are also campaigning hard to end unachievable targets and to have a sales-through-service approach rather than one of service through sales.

We are also in the middle of a huge consultation exercise, because the company has taken advantage in its harmonising of terms and conditions—for whose benefit, I do not know, but it is not for the benefit of the workforce that we represent. The company is doing away with a final salary pension scheme for people who have paid into such a scheme for their entire career, it is doing away with overtime rates and it is drastically reducing sick pay. That is unacceptable, so we are campaigning and our membership is growing, because people take the view that the company is being opportunistic.

The Convener: I am sure that Jeannie from Auchtermuchty would be delighted to get £40,000. I am keen for my constituents to get such bonuses.

Christopher Harvie: Apropos of bonuses, people might remember Tom Shields's column in the *Sunday Herald*, after Joyti De-Laurey, a secretary at Goldman Sachs, had embezzled £4 million from her trader bosses, who had not noticed. Tom Shields's comment was, "Gaun yersel, hen"—she had brought a bit of equalisation into the system.

The bonus culture has been as much about taking a big bonus and then clearing off to a tax haven, such as the Channel Islands, as it has been about taking a big bonus and remaining in a firm. It has been almost like the situation in Argentina a few years ago, when people were making for the airport with dollar bills packed into their trunks. We should not exaggerate the situation. Even the *Financial Times* has been severely condemnatory about the morality of banking. It all comes down to what banks are for. That is the issue that faces us in Britain and in Scotland.

Is there mileage in saying that we need mutuals and building societies, because the building societies that demutualised are no longer there, that we need a widespread people's banking system, such as the Sparkasse movement in Germany, which the post bank proposal deals with, and that we need banks that will provide infrastructure on reasonable terms? Remember that after the railway mania of 1844-45 a railway line was built between Edinburgh and Carlisle in about three years, whereas we have been waiting for 10 years for the line to Galashiels to be built.

The need for the banking system to define itself in terms of the public utility that it creates seems to me to be crucial, and the democratisation of power via the internet seems to offer a means of organising new forms of mutuality and common ownership. The union movement, in particular, ought to be stressing that line, because the forces against us are neither united nor—when it comes down to it—deeply honest. If we want to ensure that, if RBS is restructured by the state it can become an organisation that meets our goals, now is the time to do it. From the unions' perspective, what inhibitions are there to that type of reconstruction?

Rob MacGregor: I beg your pardon. I did not catch the final part of what you said.

Christopher Harvie: It is in many respects self-evident that we need a fundamental reconstruction of the banking system, so that we have a system that will provide, for example, the carbon neutral housing that we need—something that our great housing boom singularly failed to do—the infrastructure that we need for renewable power generation, carbon capture and the like, and public transport. We do not currently have a system that will do anything about those issues. How do we get from where we are to such a system, in ways that make use of the new mutualism that is evolving through the internet and communications in a more democratised system?

Rob MacGregor: I am not entirely sure that I share your analysis that the internet is providing new mutualism, although that is an interesting argument and I would like to explore it further some other time. I accept the charge that the opportunities that the crisis provides to create greater diversity in the financial services system are being overlooked. The mutual model was, certainly until the end of the 19th century, the most successful business model. By about 1900, there were 2,000 mutuals throughout the country.

The mutual model could be considered in relation to, in particular, savings banks—the old TSB was obviously very successful in Scotland. We now have only one savings bank in Scotland, the Airdrie Savings Bank. We must support those types of institutions. It is not just about the feel-good factor; they are part of the community. The people who manage the board of the Airdrie Savings Bank are drawn from the local community and they see that job as part of their civic duty. They bring skills, not necessarily from a financial services background but from a wider cross-section of society, and they see that they have a social duty. I do not think that there is a lot of that in the industry now. There is a lot of public relations about giving things back to the community and supporting the local football team, but it is all about marketing and brand rather than an ethical view that the organisation is part of the communities in which it operates.

We argue strongly that, in the case of Northern Rock, which is in the process of being split into a good bank and a bad bank, rather than the good bank being sold off to the highest bidder, serious consideration should be given to remutualising it and giving it back to the local community, and that that should also be the case with the Cheltenham and Gloucester. As you rightly highlighted, those institutions—like the Halifax and others—were involved in the rush to demutualise in the mid-1990s and not one of them has survived as a separate entity. Most of them have seen their branch networks disappear and are simply brand names.

We must look closely at mutuality and diversification. What is lacking is political ambition and political will. People tend to hide behind the technical aspects of mutualisation and ask how you mutualise something that was previously sold off. What lies behind that is a marked reluctance to engage and to consider other forms of delivering financial services and the wider social impact of having a more diverse industry. We are happy to engage in that debate, but the problem is that not too many others are.

Stephen Boyd: I previously quoted John McFall on mutualisation and public ownership, and I will do so again:

> "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."—[*Official Report, Economy, Energy and Tourism Committee*, 6 January 2010; c 2941.]

We have already made a major strategic error by making it clear from the word go that taking public stakes in the banks was a temporary phase and that the banks would be disposed of as soon as possible. That undermines the role of state intervention. If we are going to address the long-standing market failures in the Scottish financial services sector, there has to be a role for the state. If the current Scottish Government can bring its plans for a Scottish investment bank to fruition, I am sure that the demands on its services will be huge and I am sure that its success will provide us with an opportunity to expand on the model, perhaps into other areas, such as infrastructure, which you mentioned.

Stuart McMillan: I have a question for Mr MacGregor, following on from his comment that the FSA's regulation was treated with contempt within the industry. The final sentence of paragraph 40 of the STUC submission says:

> "For reasons that should be self-evident, the STUC would caution against continuing to promote Scotland on the basis of light-touch regulation."

The FSA is a UK-wide body, not a Scottish body, and the situation is a UK-wide issue rather than just a Scottish issue, as could be read into that sentence about promoting Scotland.

11:45

Rob MacGregor: I am sorry, but I am not entirely sure what the question is.

Stuart McMillan: The final sentence of that paragraph could be read as suggesting that it is only Scotland that has been promoted as having light-touch regulation, but the situation is a UK-wide one.

Stephen Boyd: It is my submission; I wrote it and am happy to defend it. If it is interpreted in that way, I apologise. I am clear that trying to grow the financial services sector on the basis of light-touch regulation is not a way forward for any part of the UK.

The FSA has justifiably come in for a lot of criticism in the crisis, but we must bear it in mind that, when its remit was established through the Financial Services and Markets Act 2000, it was given a duty to promote the sector's competitiveness. That cannot be reconciled with effective regulation of the sector; the remit was not right from the word go.

To be fair, much of Lord Turner's reaction since the crisis is to be welcomed. It has yet to coalesce into an effective regulatory response, but there are signs that the FSA might be moving in the right direction.

The Convener: To come back to a point that Wendy Alexander raised, should UKFI take a more active role in trying to change the corporate behaviour of the banks?

Rob MacGregor: Yes. UKFI cannot have it both ways. On the one hand, it told us that it had robust debates with the boards of the banks in which it holds shares about their bonus and remuneration culture but, when we asked it about those banks' proposed restructuring plans, UKFI said that they were nothing to do with it. It wants to get involved in the political hot potato of remuneration, but it is not happy to get involved in the nitty-gritty decisions about how those banks operate.

I will make a point about UKFI's level of accountability and its responsibility to the public. It keeps telling us that it is at arm's length and the question that we ask is: at arm's length from whom? Basically, it is at arm's length from democratic control and accountability.

UKFI should be more engaged. It is not simply a shareholder. It cannot simply be described as that. It should have a much more direct involvement and engagement with the organisations in which it holds shares. We should bear in mind the fact that it holds the shares for us, so it has a responsibility. Unfortunately, it becomes the meat in the sandwich because of who provides its remit. We understand why UKFI was set up and that it was a work in progress but we are now 12 or 18 months down the line and the organisation needs to be much more engaged with what happens on the ground in the institutions in which it holds shares than it has been in the past.

Stephen Boyd: At every meeting of the STUC general council since the crisis started, we have discussed the impact of the banking sector. The people round the table do not have Rob MacGregor's or Wendy Dunsmore's expertise or knowledge of what has happened in that sector but, when we discuss issues such as headquartering in Scotland, they continually ask why UKFI does not exert control to match its ownership stake. They simply cannot understand that. If we want headquarters functions to remain in Scotland, why are the banks not being directed through the Government's ownership stake to keep them in Scotland?

I listened to Stephen Hester describe to the committee his relationship with UKFI; I thought that it was appalling. He said that he had a good relationship with the organisation and that it was similar to that with any other large institutional shareholder, but UKFI is not any other large institutional shareholder and I suggest that there should be a step change in the relationship.

The Convener: What are the unions' views on the policies of the new entrants to the Scottish market, such as Tesco Bank and Virgin Money, on relationships with the unions and workers?

Rob MacGregor: Generally speaking, we welcome new players to the market. Tesco has a long-standing relationship with Unite and our sister union the Union of Shop, Distributive and Allied Workers. I would not say that it is any better or worse than any other institution that we deal with. We tend to judge organisations by how they treat and approach their workforces and how prepared they are to engage with stakeholders such as the trade union movement. We are willing to talk and engage with any party that wants to build that relationship.

We talked earlier about greater diversity. More new players into the market are to be welcomed, but they must be sustainable and in the market for the long term. The real danger is that companies will try to come in, make some money and then get out again. The financial services sector in Scotland and, indeed, elsewhere, has had too many such companies.

The Convener: I thank Rob MacGregor, Wendy Dunsmore and Stephen Boyd very much for their evidence. It has been helpful to get a different perspective on the banking crisis to that which we have had from some of the other organisations that we have had before us. It will certainly help to inform our report.

11:52

Meeting suspended.

11:57

On resuming—

The Convener: I am pleased to welcome Colin Borland, who is a regular visitor to the committee as the public affairs manager of the Federation of Small Businesses, and Brian Scott, who is assistant national secretary of the union Unite. Both are here representing the post bank coalition. The committee is keen to hear from possible alternative players in the banking sector, so we are pleased to have the post bank coalition with us. I invite you to make a few opening remarks before we go to questions.

Brian Scott (Post Bank Coalition): Good morning. Thank you for the invitation to present the post bank coalition's view on banking and the banking sector. The coalition consists of a number of bodies that are committed to ensuring that there is a publicly owned, sustainable post office network. Involved in the coalition are Unite, the Communication Workers Union, the Federation of Small Businesses, the National Pensioners Convention, the New Economics Foundation, the Public Interest Research Centre and the Countryside Alliance. Those groups represent a broad view of banking facilities that people need and want to use in communities. We hope that they represent the views of those who are currently excluded from the banking sector and the needs of small businesses. I will pause there to see whether Colin Borland wants to say anything else.

Colin Borland (Post Bank Coalition): I will begin with a blatant attempt to ingratiate myself by saying that making the small business case for a post bank is one of the shortest speeches that I have ever made because, whichever way you look at it, the numbers and the arguments stack up. There is already a demand for the services. About 25 per cent of small businesses already use some form of financial service provided by the Post Office, limited though those services are. About 38 per cent of small businesses would switch to a post bank tomorrow if it offered the full range of business banking services. There is a gap in the market, because 75 per cent of the small business banking market in Scotland is in the hands of two key players. There is therefore room for a serious player with a branch network, which is crucial.

The Convener: How has the proposal for a post bank been developing since it was mooted? Do you have any prospect of progress? What can the committee do to encourage progress?

12:00

Brian Scott: So far, the post bank coalition has published two documents; one in March last year and one in July last year. The first presented an argument for a post bank and outlined what it might look like; the second was a booklet or manifesto that suggested how we might set up a post bank. The post bank coalition does not regard itself as a bunch of bankers—that is difficult to say sometimes. We could not tell you how to set up a bank—we have never pretended that we could—but we believe that we have enough interest and research to say that we are looking for a bank through the Post Office, which would make the post office network sustainable. There is enough of a call for that and enough experience and consensus within the coalition to get to that point.

Our two booklets set out the way forward. In the second booklet we present four options. We referred at that point to Northern Rock. The first option was to absorb Northern Rock into the post office network to create a bank. The feeling of the post bank coalition at this point is that that is no longer an option, but the UK Government might say that there are banks that are within public ownership that could be used as a model to set up a post bank. We do not have a definitive answer, but we think that that could be a way forward.

The second option was to buy out the Post Office joint venture with the Bank of Ireland. We believe that the contract between the Post Office and the Bank of Ireland runs until 2020. We do not know the details of the contract, because they are confidential, but one way to set up a post bank would be to buy out the Bank of Ireland.

The third option was to bring National Savings and Investments in to form a post bank through the post office network. It currently has more than £9 billion invested with it. I would think that that could be used. Of course, until 1969, National Savings and Investments was part of the Post Office as a savings bank. In one way we would be taking it back into Post Office ownership—but for a much more positive reason.

The fourth option was to set up some form of mutual bank along the TSB lines, which you talked about towards the end of the session with the previous panel.

The post bank coalition is looking to have another event to generate more debate and to coincide with the closing date of the Department for Business, Innovation and Skills consultation. The coalition's view is that what is proposed in the consultation does not go far enough. The BIS consultation currently excludes the option of setting up a post bank, despite our lobbying in advance of the consultation. We think that it was wrong to miss out that option and we will hold another event, which will probably be in London, to coincide with the end of the consultation. The campaign goes on. We have a lot of support from a number of interested parties.

The second booklet—the manifesto that the post bank coalition produced—called for the UK Government to set up a working party to explore the options. I regret that BIS has not yet taken that up but we would still like to pursue it and discuss it at every opportunity.

Part of the reason we are so happy and keen to take up your kind invitation to give evidence today is that we seek the support of the committee and the Scottish Parliament for a post bank to secure the post office network—particularly the 1,400-plus offices in Scotland.

The Convener: What discussions have you had to date with the UK Government and the Post Office? Have you had any separate discussions with the Scottish Government on the proposals?

Brian Scott: There have been no separate discussions with the Scottish Government, although my colleague Andy Furey of the CWU went to what I can only describe as an open session in the Parliament at the end of last year. Interest groups can come along to the Parliament and talk to MSPs. We got a positive response, but that is the only dialogue that we have had with the Scottish Government. We have met the Department for Business, Innovation and Skills and the shareholder executive. We have campaigned and explained our position to them. I have also met the Minister for Postal Affairs and Employment Relations, Lord Young, and impressed on him our views and strongly held opinions.

I am not surprised that the UK Government's response to our proposals has been lukewarm, but it will not explain its reasons. Some members of that Government say that it is because of the costs involved. The information that we have is that setting up a post bank could cost from virtually nothing to £5 billion. We are calling for more work to be done to establish exactly what the options are for setting up a post bank. There has been a lot of talk with the Government, but I am afraid that we have not yet received a great deal of support.

Colin Borland: In June, just before the parliamentary recess, we had an event to launch the post bank campaign in Scotland and were pleased by the range of support that we received from all parties and none. The arguments that we advanced seemed to find favour. I know from other events that there are concerns about costs, which I hope we can explore in today's session. We should consider the size of the potential market and the fact that, even with a limited range of financial services and almost no business banking services, around £34 million of profits are generated every year. Half of that goes to the Bank of Ireland. We are not experts on the banking industry or on profit margins in that industry, but, looking in from the outside, the issue looks worthy of exploration. The proposal should not be ruinously expensive.

Brian Scott: I am sorry, but I forgot to say that we have had discussions with the managing director of the Post Office. The Post Office has a contract with the Bank of Ireland and finds itself in a difficult position. The managing director of the Post Office has indicated their intention to retire in May. We hope to talk to the Government soon about the replacement for that individual and the brief that they will be set in taking over stewardship of Post Office Ltd. The Post Office cannot publicly discuss in detail with us the concept of a post bank because of its commercial relationship with the Bank of Ireland.

Rob Gibson: We have an understanding of how Girobank was set up. Are there particular lessons to be learned from that? It was sold on, but what did it cost to set it up in the post office network?

Brian Scott: I do not have the figures for that. Tony Benn set up Girobank—I cannot recall the year—and it was successful. Individuals welcomed it. In the previous session, Virgin and Tesco's keenness to get into retail banking was mentioned. Tesco appears to be recruiting financial experts rapidly, and Virgin has bought a smallish bank in the south-west, which gives it a banking licence. That suggests that a bank can be set up quite quickly with minimal investment. I often think that if Virgin and Tesco consider that there is money to be made and a business to be run, an opportunity exists. There is a similar opportunity for running a post bank.

We do not have the costs of setting up Girobank, but our research so far has given various costs for setting up a post bank, which start at virtually nothing. It could be set up using depositors' funds, as was the Charity Bank in Wales. There could be minimum investment, and depositors' money could be used to fund it. Things can be done relatively cheaply.

Rob Gibson: I live in a village that is too small for even Tesco to look at. Many places in Scotland have no bank branches and are therefore potential bases. We heard evidence that Tesco Bank does not intend to become a branch-based organisation. It is the branch base of Post Office Ltd that is key. Is there anything to prevent it from setting up a post bank arrangement, apart from its contract with Bank of Ireland?

Brian Scott: We think not. The post office network is ideally suited to provide banking facilities to communities, those who are excluded from the banking system and small businesses. Our manifesto sets out a range of products, services and facilities that could be made available through the post office network. That would also make the network of post office branches more sustainable. Small sub-post offices, although perhaps not Crown post offices, survive because of footfall. They would gain more footfall and more business by having a greater diversity of products. That is the key.

The proposal is not about setting up a post bank and thinking, "Where will we put the branches?"; it is about setting up a post bank and using the current post office network. Between March 2008 and March 2009, 10 per cent of post offices in Scotland were lost; up to December 2009, 20 small offices closed, for six of which a replacement has not yet been found, so there are still gaps. Those closures happened because branches are not sustainable in their own right. We need access to extra products, services and facilities to make them viable and available to communities.

Rob Gibson: You are saying that your proposal could help to stem further closures by offering viability and that Post Office Ltd should urgently take it on board. That being the case, why is the Government in London so reticent about supporting the idea?

Brian Scott: We believe that the post bank idea is the way forward. When we heard the Prime Minister's speech at the Labour Party conference, in which he said he wanted more public services to be available locally through the post office network, we thought that that was a key. In one of the Sunday papers, or perhaps a Monday paper, there was a long interview that suggested that the post bank coalition's approach was being strongly considered. We were hopeful that the Government was leaning towards that option, but when the consultation came out it did not mention the idea. That is why we criticise the consultation for not being wide enough and not covering all the options—it specifically excludes consultation on and exploration of the post bank option.

We believe that the post office network could provide banking services. We thought that the Prime Minister was giving a signal that it would happen. We understand that the article that appeared came from somebody senior at number 10. It promised what we are looking for but, regrettably, the consultation has not delivered it.

Rob Gibson: Colin Borland said that you had cross-party support in the Scottish Parliament when you presented the proposal. Do you have such support at Westminster?

Colin Borland: From talking to our colleagues down south, we seem to. A number of early-day motions have been tabled that are attracting broad support. As Brian Scott said, though, it is difficult to pin the UK Government down on exactly where the difficulty lies. We have said that we are not banking experts but the numbers seem to add up and the opportunity seems to be there because there is a gap in the market. There are also social reasons, which you rightly highlighted, to do with the importance of post offices and other small businesses to the sustainability of communities.

12:15

We are happy to have the debate with the Westminster Government and we strongly hope that the consultation document is not the end of the process. As Brian Scott said, it does not mention the relationship with the Bank of Ireland, which is a matter of concern. The broader the coalition we can get—the more people who are speaking with one voice on the matter—the more the arguments will stack up. Indeed, the more we consider the issue, the more the arguments stack up.

Lewis Macdonald: I should put on the record my interest as a member of Unite. I am also a customer of the Post Office.

Let us consider the non-business sector. Currently, individual customers can access some banking services through the arrangements that the Post Office has with the Bank of Ireland. Will Brian Scott say what differences customers might notice if a post bank arrangement operated, rather than the facilities that are currently provided in post offices?

Brian Scott: We hope that people would be able to access the facilities of all high street branches. Currently people can access some banks, but they cannot access RBS or HSBC. We hope that access would be extended.

We hope that a post bank would offer a range of products, such as current accounts and debit cards—the usual arrangements that people have. It could be argued that such a result could be achieved through an extension of the post office card account. Last year, the Government decided to cancel the tender for the post office card account and award the contract to the Post Office again, albeit on reduced financial terms. Some £600 million per year of business is still put through the post office network through the post office card account, but the account has limited functionality. A person can draw cash from their account only in a post office branch, and they cannot even use an ATM that is attached to the post office. There are 2,000 Bank of Ireland ATMs in the UK, but there are only about 200 in Scotland, and they cannot be used to access cash from the post office card account.

People use their post office card accounts to access their benefits. Recent research by Consumer Focus found that consumers are happy with the service; the only criticism was that people can access their accounts only when the post office is open, so if they want to draw out money after 6 pm they cannot do so. We hope that a post bank would extend services, to include everything that we would regard as standard banking facilities, but that could also be done by giving more functions to the post office card account, which has restricted flexibility. For example, as well as not being able to access their funds unless the branch is open, people cannot set up standing orders from their post office card accounts.

Lewis Macdonald: What you are describing is a local post office, whether it is in an urban or a rural community, that is a mirror image of a high street bank.

Brian Scott: In as much as it would provide the same services, yes. There would be access to such services for people in communities that might well be bereft of a bank. There are far too many such communities.

Lewis Macdonald: The idea raises issues about the governance that would be put in place, to ensure that the bank operated in a customer-friendly way. You rehearsed some of the options in that regard. Are there models elsewhere in the world or elsewhere in the financial services sector that you regard as particularly relevant?

Brian Scott: Yes. I say that from a trade union perspective as well as from a post bank coalition perspective, because part of my day-to-day responsibilities is to organise Unite members who work in the Royal Mail Group. The post office workers are usually branch managers or assistant branch managers. Our research has shown that the French post office has been successful in establishing a bank during the past couple of years. The Italians have also been successful in establishing a bank.

The best example, though, is the Kiwibank, which we stumbled across recently when one of our colleagues from New Zealand came to the UK to see us. I stress that point so that the committee does not get the impression that we have been to New Zealand—we have not, regrettably, but one can live in hope. The Kiwibank is exactly what we are looking for. It was started because the population of New Zealand discovered that no New Zealand-owned banks were left. The motivation was to create such a bank. It quickly became the sixth largest bank in New Zealand. New Zealand is not a big country, but it is all relative. The stats that were given to us show that one in four residents of New Zealand has a Kiwibank account. They may also have bank accounts with other banks, but they have supported and used Kiwibank.

There are other examples. The German post office created a successful bank in the 1970s, which it sold to Deutsche Bank a few years ago. We had Girobank, which was sold to Alliance and Leicester.

Lewis Macdonald: Typically, are such banks state rather than mutual enterprises, or is there a mix of state and mutual models?

Brian Scott: In the main, the banks are owned by the postal administrations, some of which have been part privatised.

Lewis Macdonald: My next question is for Colin Borland. Some of the evidence that we have heard has been about the duopoly in the business lending market between the two biggest banks in Scotland. Are you seeking, through the post bank, to create a more competitive environment for business banking for your members?

Colin Borland: Absolutely. Although merging HBOS and Lloyds was the correct thing to do at the time—the alternative does not bear thinking about—two banks now have about 75 per cent of the small business banking market. That is the most conservative estimate; when we talk to people privately they suggest that it could be 80-odd or approaching 90 per cent. That is not healthy for competition, especially for many of the customers whom we represent, who do not have the purchasing power to walk away. For them, the choice is often between taking it and leaving it.

For some time, we have argued that there is room in the market for another serious player. Even during the boom years we had a less than perfect relationship with the banks and were concerned about the amount of genuine competition that existed in the Scottish banking market. Recent events have focused everyone’s minds on the issue.

It is difficult to expand or to get new players into the small business market because of the need for a branch network. We do business in cash and like to speak to people face to face, to pay things in and to talk to people who know us, our business and the local economy. Some large banks that have acquired a branch network in England and have a respectable market share there do not have a branch network in Scotland; that is why their market share is far lower in Scotland, although they are offering exactly the same products. The only substantial difference is the lack of a branch network. We are interested in the interventions of Tesco and Virgin because, although they have not ruled out offering small business banking services—why would they?—they have not been enthusiastic about doing so. We think that any new player in the market must offer such services.

The Post Office would be a strong candidate not only because it is a brand that everyone trusts and to which people still go—in these uncertain times, that is exactly what we need—but because it has the largest branch network in Scotland, with something like 1,400 branches. RBS has the second biggest network, with 300 and something branches. That gives you an idea of the scale of the network to which we could have access, were it to offer the full range of business banking services.

Lewis Macdonald: I will ask Mr Borland broadly the same question that I asked Brian Scott. You talked about competitiveness and the extensive branch network. Could small businesses access from a post bank any services that they cannot access from high street banks?

Colin Borland: Broadly, the difference would be between using a business account with Bank of Ireland, Clydesdale Bank or Alliance & Leicester to access money and make deposits, and using a business account with the post office bank, or whatever we call it, that would provide the full range of services, including payment options such as Bacs, merchant services and overdrafts. There is scope to link in with other Government services, for example on tax or enterprise initiatives. We might want to consider whether advice from the business gateway could be linked in. Once we start to consider the model, we see that a range of opportunities will present themselves if the infrastructure is in place.

Christopher Harvie: I am afraid that I have to leave shortly for an official dinner.

As you will have heard from my earlier questioning, I am very much in favour of a re-examination of the banking system to find out where the need for credit can be met by an intimate local response rather than the speculative response of centralised banks. I will mention two areas that I think are significant and I will ask how they can possibly come into action. One is to do with the growing number of small mutually owned concerns, from credit unions through to local tourism ventures and things that I have had experience of such as preserved railway lines. Those groups would in the first instance look to local publicly owned organisations such as those that we are talking about.

There are precedents that you could take into account. I know from my experience in Germany that there is a large public sector of German local banking, such as the Kreissparkasse, the Volksbank, and the Stadt banks, which at least theoretically are under the overall Aussicht, as the Germans say, of the Landesbanks. Things have gone very oddly with the Landesbanks in the past couple of years. The one in Baden-Württemberg has come through fairly well, but many of them went in for investment banking. As former German Chancellor Helmut Schmidt said, there are three sorts of thieves: young boys who steal apples, people with an ordinary moderate criminal tendency and investment bankers, who are more or less licensed criminals. If that comes from a German Chancellor, it is a significant condemnation.

It is important that you examine systems in which there is public banking as a local utility, otherwise you could face competition from the very confident gentleman from Tesco Bank whom we heard from. That confidence is based on the public endorsement of Tesco through sales, and they said that they could provide practically everything that is needed. However, if someone wanted to set up a butcher’s shop in a town that is dominated by a colossal Tesco, I wonder whether Tesco Bank would be willing to advance that person money. So my points are about your experience of other banking systems and your liaison with mutually owned bodies in general.

Colin Borland: We are beginning to see alternative investment opportunities being explored more. That might partly be down to the fact that people have received a less than satisfactory response from their bank, but it is also down to the fact that the current financial situation has made people think a little more about the investment landscape. There are companies that specialise in small community-based enterprises that have been turned down by banks. They are making a profit, they show no signs of waning and there seems to be enthusiasm for it. We are not wedded to one particular ownership or regulatory model; provided the bank is publicly owned and controlled and its profits are invested back into the bank, we are willing to explore other models enthusiastically.

12:30

Brian Scott: I agree entirely with that point. It is also important to state that the post bank coalition's ambition is to make the post bank a centre for the community where the customers of the bank and the post office network can access other facilities and bits of information. That could involve working with credit unions, local government and central Government to make facilities, services, products and information available in that location. We have talked about having a meeting room on the premises that could be used by small businesses. Following discussions with colleagues, it has become obvious to me that the time small businesspeople spend going to the bank and the post office is downtime for them. If, while they were at the post office, they could access Government information and do some banking, they could save valuable time.

We want to make the post office the focus for small businesspeople and the 2.4 million people in the UK who do not have bank accounts, for whom it could only be helpful to have the opportunity to have access to such facilities. We do not want to set up arrangements that make life difficult for people; we want to help them budget and manage how they pay bills and so on. We want to help people who have high tariffs for gas and electricity and have to pay bank charges because they often go slightly overdrawn because they have poor banking arrangements. We believe that the post bank would improve that situation by working with others, such as credit unions, to make facilities available.

Christopher Harvie: At the post bank meeting, I raised the notion of what I call Crown communication centres. Those would replace the old post offices, which all seem to be being sucked into WH Smith. They could be based in places such as the public library and would offer all the meeting, communication and reference facilities that are required by the microcapitalist community that is made up of small shops, bed and breakfasts and so on, which exists throughout Scotland. In larger towns, there could be local managers to whom people could speak, which would, in a way, represent the return of relationship banking. What are your views on that suggestion?

Colin Borland: In places where space is limited, we would like the services that are most important to be focused in the post office. Those that make a greater call on space might present an issue.

Brian Scott is right to talk about the advantage of people being able to carry out a variety of tasks during one trip to the post office. Nearly half of the people we are talking about are at the post office several times a week, and one in five of them are there every day the post office is open. As handy as one-stop centres of the sort that you describe would be, we are focusing on post offices in that regard, as that would allow people to be more productive.

Brian Scott: Security issues with cash and so on also have to be taken into account. Having said that, post offices have resorted to outreach services where they have had to in order to deal with certain issues. I understand that in Shetland—I am not exactly sure which part—a post office service is being provided once a week in a local village hall until a replacement post office is found. That kind of short-term or perhaps slightly longer term arrangement might be an option, as long as security and other aspects are taken into account.

That said, we should bear in mind that the £150 million social network payment is still being provided and will be required in the longer term. Our big ambition is to reach a point at which the post office network is sustainable and to reduce or even eradicate the social network payment. I do not particularly want to set ourselves up for a fall, but the network needs to exist. The current Government has said that it will not close any more offices—at least none of the 363 Crown post offices left in the UK—but, nevertheless, that will still incur a cost for Government. We need to increase footfall and improve products and services, because the future of the post office network lies partly in the financial services model. No one will deny that the network offers a good service in that respect, but by increasing footfall and reducing the social network payment we will be able to secure the network's future. Indeed, in the foreseeable future, we might even be able to put back into their own buildings an increasing number of post offices that have been set up in, say, WH Smith.

Stuart McMillan: I was going to ask a question about other models, but Lewis Macdonald got to it before me. Given the cuts to services over the years, I think that any proposal to increase the services that are offered by and the opportunities for the post office network must be considered seriously, and in that regard I very much welcome the post bank proposals.

Given that, as Mr Scott has pointed out, the folk in the current post bank coalition are not bankers, if the post bank proposal went ahead, surely there would be massive challenges in finding the right people and setting up the organisation. Where would its headquarters be located? How many more people would be needed to establish a post bank?

Brian Scott: I could sit on the fence and say that I do not know where the headquarters should be or I could simply say that it should be in Scotland. However, the fact is that I do not know. Challenges certainly exist, but the task is not as big as might be envisaged. After all, the infrastructure already exists and there has been a lot of investment in the current post office network. Post Office Ltd is also rolling out an improved, updated version of Horizon Online, the electronic system that you see people using behind the counter, with more functionality and, as I understand it, room for expansion. As a result, there is already a data network and a branch network. Of course, some back-office activity would have to be established.

The post bank's identity should reflect the country in which it operates. I am not necessarily saying that there should be a post bank Scotland—then again, why not?—but there should be some recognition of the post bank's Scottish or, I guess, Welsh operations. I am not sure whether Northern Ireland is big enough to have its own post bank.

We would certainly want the post bank to respond to the specific needs of rural or urban communities in different parts of Scotland, and indeed to have a presence in the country. I have in the past been critical of the way in which Royal Mail has removed its presence in Scotland and Wales. For example, West Port house in Edinburgh used to be the home of the Scottish Post Office Board, but Royal Mail Group has since moved away from that identity and the organisation no longer exists.

Colin Borland: I have nothing to add, other than to say that I wish we were at the stage of having negotiations about the points that you raise, because when we have reached that stage we will have won the argument. When that happens, the FSB in Scotland will underline the importance of vesting decision-making powers where they are of most importance.

Aside from the headquarters issue, job creation in local communities is important. The networks and the positions that will be created will expand as demand expands. If the product that we propose to provide is the correct one, the demand will exist, as we have demonstrated through the research that we have carried out.

Stuart McMillan: If the post bank comes to fruition, it will be something new and innovative. To reach out to different sectors in Scotland and to the 2.5 million people—I think that that is the figure that was mentioned—in Scotland and the UK who are somewhat disengaged, one option would be to have a headquarters outside the traditional headquarters bases. That would ensure that the post bank was more aligned to individual customers and small businesses. I pose that as an idea to consider for the future. As a West of Scotland MSP, I would be keen for the post bank's headquarters to come to the west of Scotland. Such a move would help the post bank to have a different identity and should certainly be considered.

How much consultation has been undertaken with members of the general public, as opposed to among people who have been involved up to now, such as members of the business sector and other partners, to promote the idea of a post bank?

Brian Scott: We have used other research to inform our thinking. Consumer Focus Scotland recently issued a booklet entitled "Opportunity knocks—providing alternative banking solutions for low-income consumers at the Post Office", which supported the assumptions that we had made on the basis of previous research. We do not have a facility for holding a wide public consultation, but as I said earlier, our second post bank coalition booklet called on the Government to set up a working party to consider the options. We expect wider consultation to be one of those options, and we hope that the Government will take it up at some stage.

Stuart McMillan: Has there been any consultation with or information gathering from the wider membership of Unite, to garner opinion on whether a post bank is a good idea?

Brian Scott: The feedback from some of our members who work in the branch network, such as branch managers and assistant branch managers, is that their customers would like to have a banking service from a more trusted brand that is much more local and to which they can relate. The number of people with a Post Office account increased when the banking crisis started, primarily because of the Bank of Ireland's launching of a new Post Office account. People feel more secure with the Post Office and feel that they have a relationship with it—they feel that it is part of their community. The feedback from members is that there is a lot of customer support for the proposal.

We are in the process of preparing a postcard campaign. We are trying to get Post Office Ltd to agree to put postcards about a post bank on the counter, so we have begun to undertake the process that you talk about of getting people's feedback. Not surprisingly perhaps, because of its contractual relationship with the Bank of Ireland, Post Office Ltd is not falling over itself to help us with that. However, the postcard campaign is a real opportunity to get feedback from individuals.

Other research is in line with what we expected. For example, information from the FSB suggests that 38 per cent of small businesses would definitely use a post bank. The Consumer Focus report "Opportunity knocks" shows that 65 per cent of those who use a post office card account only are very satisfied with it, but between 40 and 50 per cent of users would like more functionality. Consumer Focus points out that individuals who rely on a post office card account—bear in mind that some people have no bank account at all—are not always aware of the facilities that could be made available to help them to deal with their finances.

12:45

Colin Borland: The FSB has consulted its membership widely and repeatedly on how small businesses use post offices, what services they want to be available from the post office and whether they would like a post bank. As Brian Scott said, the overwhelming message is that small businesses use, value and trust post offices, and also depend on them. We would like the services that the post office offers to be expanded so that, for example, we can do our business banking in the heart of our community.

We would also like to be assured that decisions can be taken at the local level. Rather than decisions being taken in a call centre in Edinburgh or in London or on the other side of the world, we would be much happier if decisions were taken by people who know our business, who know the local market, who know whether we are worth investing in and who know what sort of advice is appropriate to us.

We have a fairly strong evidence base. In September 2009, we published a report—I can ensure that the clerk gets a copy of it—on the future of postal services. That report is not purely about a post bank, although that is dealt with in one chapter; it considers the issue across the board by looking at how small businesses use the post office network.

The Convener: I have one final question. The witnesses might not be in a position to give a full answer on this, but from the work that you have done to date, are you aware of any regulatory barriers—either existing or coming down the line—that might make it more difficult to establish a post bank?

Brian Scott: The only issue, I think, is that Post Office Ltd does not have a banking licence. That is the big challenge.

The Convener: For example, additional capital requirements are now being placed on banks. The Building Societies Association has also raised concerns about the excessive cost for mutual organisations, which are required to pay the Financial Services Authority for the guarantee schemes. Have those issues been considered in the context of a post bank, or will they be considered further down the line?

Colin Borland: In terms of the Basel II capitalisation requirements, I think that the models that we have looked at, such as that of National Savings and Investments, would address the issues. As far as we are aware, we have not come across any insurmountable obstacles.

The Convener: I thank Colin Borland and Brian Scott for their evidence this afternoon on the interesting issue of the post bank. I am sure that we will consider how we can take matters forward during the course of our inquiry.

12:49

Meeting suspended.

12:50

On resuming—

Work Programme

The Convener: We will continue with evidence on our banking and financial services inquiry at our next meeting. We hope to hear from more investment managers, representatives of the accounting profession and a credit ratings agency, so that should be fun.

The next agenda item is our forward work programme. I will give us an update on where we are and ask members to consider priorities. We have already launched our next inquiry, which is on international trade, exports and inward investment. The aim is to take oral evidence on that from March to May.

We have agreed in principle that we will then have a review of the restructuring of the enterprise and skills agencies. I suggest that we take evidence on that in June, after we have completed taking oral evidence on the international trade inquiry.

We have one or two outstanding items to fit in, one of which is budget scrutiny. As you might be aware, the Finance Committee has proposed that what is called a stage 1 budget strategy phase should be conducted for the next financial year, which means that we would have to take some evidence in April or May.

We have also agreed in principle to have a hearing on the whisky industry, a follow-up to the tourism inquiry and an evaluation of homecoming. We might perhaps look again at the National Trust for Scotland, particularly after George Reid completes his review of it. Finally, we will do a follow-up to the energy inquiry at some point—a year or so after we have completed it. I do not want that to be left on the back burner, if you pardon the pun.

Rob Gibson has proposed a possible one-off hearing on the response of the utility companies to the winter crisis. The committee has not considered that matter before but might wish to consider it in future.

Rob Gibson: In our international trade and exports inquiry and the one-off round-table discussion on the whisky industry, it is important to look at two sides: the impact of the whisky industry going out the way and the effect on bottling plants and practices in Scotland. I hope that we make it quite clear that we will cover both those aspects in the international trade inquiry and in the round-table discussion. We heard in the news this week that Whyte and Mackay has been increasing its profits but is still cutting jobs in the whisky industry and not promoting it in the way that it deserves.

That deserves our attention. The industry is an exemplar of how the two issues of international trade and jobs at home overlap.

Lewis Macdonald: Whisky is bound to be a major focus of the international trade inquiry. We want to hear evidence on the industry's current position. There have been particular issues around the workforce, and we want to hear from both the industry management and the trade unions that represent the workforce about those issues going forward. It would also be useful to hear from both sides about the minimum pricing of alcohol and alcohol policy, and their potential impact on the industry. We should have a round-table discussion on those aspects and leave the international aspects to the international trade inquiry, as we will inevitably discuss them in that context.

Rob Gibson: We could have some representatives of Tennents along.

Lewis Macdonald: We should simply ask the clerks to go away and identify dates for the things that we have agreed to inquire into.

The Convener: Are members content with the paper and happy to leave it to me and the clerks to programme the business? We will try to ensure that our meetings are not too long, but that we pick up all the issues in the paper.

Rob Gibson: Will you include the one-off hearing on the power utilities?

The Convener: I was going to ask about that. As well as what we have agreed so far, Rob Gibson has proposed a one-off hearing on the power utilities and their response to winter maintenance. I do not know what members views' are on that. Do members think that such a hearing would be valuable?

Lewis Macdonald: Could Rob Gibson briefly indicate the reasons for his proposal?

Rob Gibson: There is an issue about maintenance by the power utilities and also an issue about their customer service at particular times. We take an interest in the power industry in relation to energy development, but it would be interesting to find out how it got on in practice during the winter. There will be moves in other parts of the Parliament to consider how we coped with the particularly severe weather. Energy is an area in which the committee has a locus and it would be worthwhile to consider the industry's response, at least on a one-off basis.

Stuart McMillan: That is a legitimate request and a legitimate area for the committee to consider. There might be more issues in rural communities than there are in urban parts of Scotland. It would be worthwhile to consider the matter.

Ms Alexander: It is a legitimate area, but there are many ways in which to approach it. I would be happier if our consideration fell out of a piece of work that another committee was doing and wanted us to look at. Otherwise, it could get a bit fragmented. We should let somebody else take the lead. If they decide to invite the power companies in, that is great. If they insist that we do that, so be it. I do not think that we should set a hare running when the work should be led by the Public Petitions Committee, the Rural Affairs and Environment Committee or somebody with more of a locus to take an holistic view of the matter.

The Convener: I suggest that the clerk and I liaise with other clerks to find out if any other work is being done. We will then try to work out a logical work programme, taking into account the work of all the committees. If it is logical for us to deal with certain issues, as Rob Gibson suggests, I am happy to bring that back, but the point about co-ordination is important because other committees might already be looking at the issues. Is that agreed?

Members *indicated agreement.*

Scottish Trades Union Congress (Seminar)

12:58

The Convener: The final item is our proposed joint seminar with the Scottish Trades Union Congress. The seminar has become an annual event. No specific theme has yet been proposed for the seminar in 2010. When I spoke to Stephen Boyd after he gave evidence this morning, he suggested that, although the digital Britain theme will be dealt with separately, there is a possibility of rolling the support for manufacturing theme into our joint seminar. The other theme that I think might be useful given our future work programme is Scotland and the global economy, but I am open to suggestions.

Lewis Macdonald: I have three brief points. First, we should probably choose a date after 6 May, for one reason or another.

The Convener: Are you sure that 6 May is the right day?

Lewis Macdonald: I am not Lord Ainsworth, so I could not possibly comment.

Secondly, I know that the committee has a busy schedule, but it would be useful if the seminar could be held in place of a committee meeting, because that would give it the status and profile that our meetings tend to have.

Thirdly, on the subject area, it would be interesting and useful to examine the Scottish economy's response to the recession and any consequences of that for employment or social policy as seen from a trade union perspective.

The Convener: On the basis of that discussion, we will go back to the STUC and start looking at possible dates. We will need to work out how much oral evidence we need to take for our other inquiries so that we can work out whether we can free up a committee meeting slot.

I forgot to mention during our discussion of the work programme that the census order will come to us at some point. We do not know when that will be.

That concludes today's meeting. Thank you.

Meeting closed at 13:00.

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