ECONOMY, ENERGY AND TOURISM COMMITTEE

Wednesday 10 February 2010

Session 3

£5.00

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

CONTENTS

Wednesday 10 February 2010

ECONOMY, ENERGY AND TOURISM COMMITTEE
6th 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:

Dr Gary Gillespie (Scottish Government Strategy and Ministerial Support Directorate)
Gordon McGuinness (Financial Sector Jobs Task Force)
John Swinney (Cabinet Secretary for Finance and Sustainable Growth)
Mark Tennant (Financial Services Advisory Board)
Jim Watson (Financial Sector Jobs Task Force)
David Wilson (Scottish Government Enterprise, Energy and Tourism Directorate)

CLERK TO THE COMMITTEE

Stephen Imrie

SENIOR ASSISTANT CLERK

Katy Orr

ASSISTANT CLERK

Gail Grant

LOCATION

Committee Room 4

Scottish Parliament

Economy, Energy and Tourism Committee

Wednesday 10 February 2010

[THE CONVENER *opened the meeting at 10:30*]

Financial Services Inquiry

The Convener (Iain Smith): I welcome colleagues to the sixth meeting of the Economy, Energy and Tourism Committee in 2010. The only item on the agenda is our banking and financial services inquiry, for which we have two panels of witnesses.

Our first witnesses are Jim Watson and Gordon McGuinness from the financial sector jobs task force, and Mark Tennant from the Financial Services Advisory Board. I welcome you all to the meeting and ask whether you would like to make any opening remarks.

Mark Tennant (Financial Services Advisory Board): Thank you for having me here. This is a very good moment to have an opportunity to talk to you about FiSAB. I will introduce myself quickly. I have now been in the financial services industry for 37 years, so I am reaching the twilight of my career. I have been through two crashes, and I have worked in every sector except retail banking, so please do not ask me anything about that.

To put FiSAB in context, it was the creation of Jack McConnell and John Campbell, my predecessor. The role that was envisaged for it is the one in which it now operates, which is to act as the communications link between the Scottish Parliament, the First Minister and the Government, and the financial services industry, which is Scotland's second largest. FiSAB fulfilled that role extremely well under my predecessor, and I am grateful to the current Administration for picking up Jack McConnell's ball and running with it.

There is no question but that FiSAB's role is increasing. It has done a great deal of work on alleviating the pain of the banking crisis in Scotland. I should particularly mention the financial sector jobs task force, which has done a good job of picking up a number of the difficulties that we faced. The communication between the task force and FiSAB is strong and we work very closely together. Without the task force and the channel of communication, the pain that has been felt by those who have lost their jobs would have been much worse.

Some people have asked what the value of FiSAB is. I heard that asked when I was in the run-up to taking this job, which I have had only for a couple of months. The job lies first in communication, and secondly in the collaborative nature of FiSAB's relationships with the various arms of Government and Government agencies, and with Scottish Development International as it tries to ensure that Edinburgh, Glasgow, Aberdeen, Dundee and Scotland generally are great places to bring financial services companies, thereby increasing Scottish employment and gross domestic product.

There are now three very clear strands that we want to follow. The first is to ensure that central Scotland and other parts of Scotland continue to be places to which we can attract financial services businesses. In terms of devolved matters, that centres on communications, by which I do not necessarily just mean airports; I mean data communications, which we need to improve in Scotland, as well as communications generally.

Secondly, we need to continue to provide and hold a pool of skilled labour. All the conversations that I have had with members of Scottish Financial Enterprise have suggested that we have a strong pool of skilled labour. The education system here is working in that respect. All we want to do is ensure that that continues, because there is no question but that the third strand, which is Scotland as a great place to live, almost does not need to be improved. I have worked in Edinburgh, London, Hong Kong and New York, and I know that I would rather work in Edinburgh. There is a wonderful quality of life here, and Edinburgh is a beautiful city, as are Glasgow, Dundee and Aberdeen, which is close to where I live. From that perspective, everything is in place.

However, other things have happened. I thank Gavin Brown for all the work that he did on the European Union alternative investment fund managers directive. I also thank David Whitton, who is not here. A tremendous amount of work has been done on the issue. It would have been catastrophic if the directive had gone through in its original format. Many thanks for all your support, which was extremely useful. That side of things also works well. FiSAB is the forum for the partnership between financial services and Government.

Jim Watson (Financial Sector Jobs Task Force): I thank the committee for giving me the opportunity to give evidence. I am here in my capacity as chair of the financial sector jobs task force. I represent Scottish Enterprise on the task force and my colleague Gordon McGuinness represents Skills Development Scotland.

The purpose of the task force is to minimise the job losses in financial services and ensure that, as far as possible, we retain the skill sets, particularly in the short term, so that they are still available to us when confidence returns. The membership of the task force is largely public sector, although we have SFE and union representation. The aim is to ensure that support services from the public sector to the financial services industry are effectively co-ordinated.

The task force has been running for a little more than 10 months and meets regularly. We think that it has made a lot of progress in a relatively short time. The co-operation between partners in the task force has been first class and the response from the industry has also been excellent. There has been a genuine desire to work in collaboration, because we all realise that we are trying to help people through very difficult times.

In general, until about the end of October, it felt as though we were weathering the storm fairly well. We were faring better than expected, although that is no consolation for the people who are leaving employment, of course. At the end of November, the announcements from the Royal Bank of Scotland and Lloyds Banking Group were a sharp reminder that we are not out of the woods. During the next six months, the task force will need to continue to work closely with financial services businesses.

Mark Tennant: We need to make very clear to the press and everyone else, particularly in Scotland, that although we have had a banking crisis and there are difficulties in the banks, the financial services industry in Scotland is alive and extremely well. If we consider the insurance companies, the asset managers and, in particular, the asset servicing companies—the companies that do fund accounting and much of the clerical work in the fund management and insurance industry—it is clear that Scotland is a leader in Europe, along with Dublin and Luxembourg. The financial services industry is a high-employment industry. Let us not believe that Edinburgh is “holed below the waterline”, as Magnus Linklater tried to suggest on the radio the other day; it is not.

The Convener: A key role of FiSAB is to enable a rapid response to changes in the operating environment. How did FiSAB react to the financial crisis? Were more meetings held? Did you discuss specific aspects of the crisis? Did your strategic approach change?

Mark Tennant: I was not here during the crisis, so forgive me if I cannot give you an insider’s knowledge on that. If FiSAB had not existed, the situation would have been a great deal worse. First, it was able to communicate with the banks at a time when they were in some difficulty. It was able to give out the message that certain parts of the banks, particularly on the retail side, were alive and well and doing a good job. Secondly, it was able to work with Scottish Enterprise to ensure that, as the difficulty arrived, we were able to redeploy people and find people jobs. If FiSAB had not existed and that had not happened, that would not have worked and there would have been a lot more pain.

FiSAB was also able to ensure that, as we went through the crisis, the First Minister was properly briefed about the difficulties that the Scottish banks were having.

The Convener: Some sectors have withstood the crisis better than others have. What analysis have FiSAB and the financial sector jobs task force done on that? What lessons have you learned from the financial crisis and its impact on Scotland?

Jim Watson: The task force has considered a number of sub-sectors. We did comprehensive research on asset management and servicing and we are discussing with industry how best to capitalise on what we think is a good market opportunity for us in Scotland. Banking has taken a fair hit during the past 18 months, but other sub-sectors have fared quite well. We are considering general insurance and life and pensions, and the plan is to take forward, through Scottish Financial Enterprise, a strategy for those sub-sectors and perhaps to enhance the propositions around them.

Mark Tennant: Outside the Scottish Enterprise partnership, within FiSAB and SFE we have begun to find ways of putting organisations together, so that, when one organisation is shedding labour, others are there to take it up. At the very bottom end, where the pain is really felt, it is possible—indeed it is quite easy—to retrain people, so that they can move from banking to insurance. I am talking about the clerical end. As long as the person is numerate, retraining is not difficult. It is also terribly important, because the one thing that we do not want to lose in financial services is the pool of labour that we have generated. We do not want that pool of labour to go somewhere else.

Jim Watson: General insurance offers a good example of the tie-in between FiSAB, the industry and the task force. Ian Ferguson presented the lessons that have been learned from the centre of excellence in Perth and will be on the steering group for our research on general insurance. That is a good, practical example of the type of tie-in that we are getting between the various mechanisms that we are using.

Mark Tennant: The Perth example is a good example of how Scotland managed to retain a site. Not only has that site, which had been General Accident—members might remember that General Accident was taken over by an English insurance company, Commercial Union—been maintained, it has thrived, because it is a great place to be.

The Convener: The Scottish Government's strategy for the financial services industry in Scotland predates the crisis and indeed the setting up of FiSAB—in part, FiSAB came out of the strategy. Has the strategy been reviewed? Is FiSAB considering whether the emphasis needs to change? Should areas in which there is strength, such as general insurance, asset management and life and pensions be regarded as the backbone, rather than banking?

Mark Tennant: Yes, absolutely. We are looking particularly at two things outside information technology infrastructure, education and the pool of talent. First, the simple fact is that, whichever way we look, we must look east. The future is not in Europe; the future is in Asia, for almost all our members and all the financial services operations here. A great deal has been done with my chief executive at SFE, Owen Kelly, who, as you know, speaks fluent Mandarin and is an Oriental expert. I, too, have worked out there. We have successful companies out there. Standard Life has joint ventures in China and India. Martin Currie is a tiny fund management shop in world terms but, if you mention the company in Hong Kong, you will find that everyone has heard of it. Asia is critical.

Secondly, we are beginning to move into the issue of how we deal with finance at the very bottom end of the scale, for the poorest people. What can we do to co-ordinate microfinance—we have seen the possible arrival of the Grameen Bank in Sighthill in Glasgow—and learn from it so that we find a way of making banking and financial services better for those at the bottom end of the scale? That is not even being done in England, so there is no harm in our pioneering it.

The Convener: We might explore that a bit further later on.

You say that the strategy is being reviewed. Is it FiSAB's intention to publish, along with the Government, a fresh financial services sector strategy document?

10:45

Mark Tennant: I am not sure that we will publish a fresh strategy. I am not good, even in a bank, at having a big-bang strategy with tonnes of PowerPoint presentations.

Strategy evolves as markets evolve. The clear breaking away of Asia is happening more as a result of the crisis than of what happened before the crisis, although it was somewhat embedded before. That is now beginning to take off and it is possible to see Asia decoupling for the first time as we come out of the crisis. That has evolved and we now have it as a strand. Microfinance is dear to my heart and to Alex Salmond's. Determining how we ensure that the poorest of our people are properly served is a new strand.

We will develop strands. I am not good at big strategies. Those are for Government.

Jim Watson: The financial services implementation group—FiSIG—has spent some time considering on behalf of FiSAB whether we should make any changes to the strategy. Those deliberations will be reported back to FiSAB at the next meeting in March. A different emphasis is coming through, which will be approved or agreed with FiSAB in March.

Marilyn Livingstone (Kirkcaldy) (Lab): Despite the fact that few official figures are currently available to show the impact of the financial crisis on employment, has the financial sector jobs task force been able to build up a picture of the scale of job losses?

Jim Watson: We all know the difficulties of trying to assess with a degree of accuracy the actual impact on employment. Certainly, if we compare the losses in gross value added over the past seven quarters with the employment loss, it appears that there has been a lag in job losses.

We have been notified of around 2,500 job losses, primarily in the banking sector. The vast majority—more than 70 per cent—are voluntary redundancies, with quite a large proportion being earlier retirement; one in seven is a compulsory redundancy, which we believe is below the United Kingdom average, so we have fared slightly better in that respect.

There have been few locational decisions. That is, there have been few examples of a company comparing Scotland to a part of England and making a choice about whether to keep jobs here. In general, efficiencies have been made right across a business.

There have been job losses from a wide range of types of job, from IT services to administration. The losses have generally been in lower-value jobs rather than the higher-value ones about which we were concerned initially.

There have been some very impressive redeployment figures, ranging from 10 per cent to 28 per cent in some instances. The two bigger banks in particular—Lloyds Banking Group and RBS—have been pretty successful in redeploying some of the staff who were at risk.

Mark Tennant: There is nothing like that redeployment in London, and London has suffered as a result.

Marilyn Livingstone: How do we ensure that, if we face such a crisis again, we have the appropriate statistics?

Gordon McGuinness (Financial Sector Jobs Task Force): The gathering of statistics has been quite difficult. In general, companies are going into a period of unprecedented change. A number of the banks have rightly looked to employment legislation and sought to consult staff in advance of making any external announcements. Traditionally, the partnership action for continuing employment—PACE—redundancy service would have been closer to companies than it has been. It has been quite a challenge.

Many banks and larger organisations are using private out-placement organisations to deliver fairly sophisticated services. The public sector's level of engagement in working day to day with those organisations has been slightly different from normal, so we do not have the up-front statistics that we normally gather. There are a couple of exceptions; one is the work that we did with the Royal Bank when it closed a cash centre in Glasgow. We saw almost every member of staff there, so we can track them. We have partnership working arrangements with out-placement organisations, but our ability to continue to collect accurate data has been diluted.

Marilyn Livingstone: The committee will make recommendations to the Government. One issue is that we need to know where the job losses are. PACE teams cannot help if they do not know that a problem exists.

One point that has certainly come over to the committee is the need to have a highly skilled workforce. Mark Tennant and Gordon McGuinness have said that one of the greatest advantages of the financial sector in Scotland is its pool of skilled staff. Is the panel concerned about recent announcements such as the one in *The Herald* today that only one in every seven people who would like to enter university will receive a place? We hear that Scotland's colleges are bursting at the seams. That is a huge issue, in which Gordon McGuinness is involved with his Skills Development Scotland hat on. The skills gateway is being established and we have the task force, but are we in danger of not allowing people who have the necessary qualifications and skills to access further training that could help them to be redeployed, for example?

Gordon McGuinness: I would not call it a Rolls-Royce service, but those who have left the banking sector—particularly larger employers—have received a comprehensive service. In the public sector, we in PACE have sought to complement that with our services. We have established freephone helplines and created a fairly robust web channel from which individuals can source information.

In the longer term, promotional campaigns to attract back to the sector not just young graduates but people who have worked in the sector will be used. The banks had been robust organisations and had pretty much developed in-house graduate recruitment and development programmes. Those programmes have not totally disappeared, but they will certainly be smaller than before.

Collectively, we can work with the sector to build stronger links between academia and industry. We can think more about graduate internships and placement programmes. In the short to medium term, that should address the reduction in structured graduate recruitment programmes. Different approaches can be taken. We must also work with professional bodies on continuing professional development and provide access to paths back into the industry through refresher programmes.

Jim Watson: Another good practical example from the task force is the work that Scottish Enterprise has done with Scottish Investment Operations to launch a formal investment management qualification. In the short term, gaining that qualification helps individuals to redeploy in a group. It also gives Scotland a competitive advantage, because it is unique to Scotland.

Mark Tennant: Employment in the financial services industry is in three parts. One part is the rocket scientists—the people who work in investment banks, in fund management and in derivatives and who do all those good things. Those people are drawn from an international pool of labour. From its universities, Scotland provides its share of them.

The second part involves universities, which Marilyn Livingstone just talked about. It is critical that we maintain the pool of labour that comes from universities.

We must not forget that, in the clerical world, there are also those who come straight from school. That is where the national vocational qualification is important. It is critical that we keep up the mathematical education in schools so that people come out highly numerate. The fact that people cannot go to university does not prevent them from working in financial services. In fact, we need those people, so we should not merely stop at universities; we need to look further down as well.

Marilyn Livingstone: I mentioned Scotland's colleges because I am concerned about the vocational aspect of training. The worry for the committee is that people are being turned away and that colleges and universities are full to bursting. As Mark Tennant said, and as we have heard in other evidence, the financial services sector needs highly numerate graduates with a good base in financial services. Is that crisis in the education sector an issue for the financial services sector? We have a highly motivated and skilled workforce, but we need to keep it for the future. I want your view on the current situation and the impact that it might have on financial services.

Mark Tennant: We all need to be concerned not just in Scotland but UK-wide about the economic environment that we face. That will inevitably affect all services, whether it be education, health or something else. The possibility of a declining pool of talent must be a concern. One reason why FiSAB exists is to try to put pressure on Government, through bodies such as the committee, to ensure that the pool of talent continues. I suspect that that will be increasingly difficult as we proceed, but we must face that challenge. The fact that we have FiSAB and Scottish Enterprise puts us one step ahead of other places.

Gordon McGuinness: In the mid to longer term, we are in the process of establishing the skills gateway with industry representation. That will fit into the work of FiSIG and FiSAB. The model that we are developing with other key sectors is to develop a longer-term skill investment plan that is fully informed by industry. We will then take that to the Scottish Further and Higher Education Funding Council, Scottish Enterprise and Skills Development Scotland to lay out a longer-term investment plan. However, it is a two-way street—we need industry to engage with us and to provide opportunities through work placements, internships and jobs in the longer term. The issue needs a longer-term view. Come the summer, there will be real pressure on the college and university sector.

Gavin Brown (Lothians) (Con): I want to double-check something with Jim Watson. He mentioned a figure of 2,500 job losses. Some of the established banks in Scotland have lost positions, but others such as HSBC, from which we heard evidence, are recruiting. Is it a net or a gross job loss figure?

Jim Watson: It is not net—it is 2,500 job losses. I have not included the inward investment, for example by Tesco and esure.

Gavin Brown: As you said, it is not an official figure, but it is your best estimate based on what people have told you, so there will be job losses that you do not know about. However, is 2,500 pretty close to accurate as a ballpark figure? There might be another 100 out there, but would you be surprised if there were another 1,000? I am just trying to get a feel for how accurate the figure is.

Jim Watson: It is reasonably accurate. I suspect that the two major sets of job losses are those in the Royal Bank of Scotland and Lloyds Banking Group. Some of the others have been relatively small. We have a list of jobs that are currently at risk that are not part of that 2,500. The majority of the jobs that are at risk following the announcements from RBS and Lloyds at the end of November are not part of that 2,500. Taking those announcements into account, I reckon that there could be another 1,000 to 1,200 job losses in the pipeline over the coming six to nine months.

11:00

Ms Wendy Alexander (Paisley North) (Lab): I want to ask about a policy issue. The chair of FiSAB is the First Minister, who is committed to a separate financial services authority for Scotland. Does the board share his view?

Mark Tennant: I do not have a view on the matter one way or the other. If and when we have a referendum on independence, that debate will no doubt occur. However, we do not face that situation right now.

Ms Alexander: I think that the view of FiSAB's chair is that Scotland should have a separate financial regulatory authority now. Has that topic been discussed by FiSAB?

Mark Tennant: Wendy, the matter is not devolved. If that is the First Minister's view, I can entirely understand it and he is absolutely entitled to have it.

Ms Alexander: So whether Scotland would best be served by having one or two regulatory authorities has not been discussed by FiSAB.

Mark Tennant: There is no need to discuss it, as it is not an issue. There is one regulatory authority, which is down in London. As far as I am aware, there is no move in London to have two regulatory authorities. If such a move is made, we will no doubt discuss it.

Ms Alexander: Given that we have one regulatory authority at the moment, has FiSAB sought to have the chair or chief executive of the FSA, or the governor of the Bank of England, speak to it at any point in the past year?

Mark Tennant: FiSAB actually includes a member from the Treasury, who attends from time to time and normally just listens. No, we have not had the governor of the Bank of England up as yet. However, SFE invites those sorts of people to come up here.

Ms Alexander: Given what we have been through in the past two years, when regulatory issues have been at the very top of the agenda, people might find it puzzling that FiSAB has not sought to speak to either the chair or chief executive of the Financial Services Authority or the governor of the Bank of England.

Mark Tennant: That is a matter for the Scottish financial services community, which is governed by the Financial Services Authority. It is not a devolved matter, Wendy.

Ms Alexander: Does FiSAB have no role, then, in making representations on those matters?

Mark Tennant: FiSAB has a role in making representations about Scottish financial services in Scotland, including on jobs and other matters. Regulation is a matter for the UK.

Ms Alexander: So FiSAB's only purpose is to make representations in Scotland, but it does not make representations on behalf of Scottish financial services to, for example, any of the tripartite authorities.

Mark Tennant: As I said at the beginning, FiSAB's role is to provide communication between the First Minister and the financial services world in so far as that deals with devolved matters. That is what FiSAB does and that is what it will continue to do.

Ms Alexander: I would like to probe that role. FiSAB is the owner of "A Strategy for the Financial Services Industry in Scotland", which was published in 2005. As other members have alluded to, people find it strange that FiSAB is working to a strategy that is now five years out of date—

Mark Tennant: We are not. With due respect, I said that we have started two further strands, of which one concerns Asia and the other concerns microfinance in Scotland. As I said, strategy evolves; it does not change.

Ms Alexander: But you have not published that strategy. FiSAB publishes an implementation plan annually on a strategy that is now five years out of date.

Mark Tennant: No, strategy evolves. Bear in mind that those two strands started when I first came to FiSAB and we have had only one meeting since I arrived. We have another meeting in March, at which a further update will be given to FiSAB. When we are clear about precisely how the Scottish financial services industry should leverage any strategy that we have on those two strands, we will publish it. But there is no point in publishing something that is half-baked.

Ms Alexander: Forgive me, but you said earlier that the strategy for financial services is for the Government rather than for FiSAB. We have a strategy that was published in 2005 that was jointly owned by the Government and FiSAB. You have stated today that, for the future, strategy is a matter for the Government. That clearly represents a change from the status quo.

Mark Tennant: No, I did not say that. You asked me about whether there should be a single regulator or a dual regulator, which is simply not a question for FiSAB.

Ms Alexander: I have moved on from that issue.

Mark Tennant: I am glad to hear it.

Ms Alexander: According to the website, the strategy for financial services is jointly owned by the Government and FiSAB but, in response to the convener, you said that strategy was not for FiSAB but for the Government, so I am trying to understand the status of the existing strategy and whether we can expect a replacement at some point in the future. A worthy strand of work on things moving east is not the same as the strategy for financial services in Scotland and what that is. We have a strategy that is five years out of date. It is quite proper for me to ask whether it will be updated and, if so, whether that will be done by FiSAB or—as you appear to have indicated—the Government. I just want clarity.

Mark Tennant: The answer is yes, it will be updated by FiSAB as and when we go forward. I am sorry, but I come from a commercial organisation. We do not publish strategy; strategy evolves. Given that we have a fast-changing marketplace, it is critical that FiSAB and, indeed, the Scottish industry face up to those changing circumstances as they occur. The idea of producing a strategy paper once a year is an interesting one, but how we execute the strategy in the intervening period is far more important.

Ms Alexander: You currently publish an annual implementation plan against a strategy that is five years out of date.

Mark Tennant: I am sorry, but it is not out of date. Where I come from, it does not work that way. We have a strategy that evolves over time. We do not publish strategies on an annual basis because, frankly, that is an absurd thing to do. A strategy was set out by FiSAB at the very beginning, which is still in place and is evolving. I have mentioned two strands that are being looked at.

Ms Alexander: Let me turn to the big strategy issues of the day.

The Convener: Jim Watson wants to comment first.

Jim Watson: I do not know whether this will help, but in November 2008, FiSAB carried out a scenario-planning exercise to revisit the strategy and look at the implications of the recession. Wendy Alexander mentioned the implementation plan, which I think is the vehicle that has been used to make changes in emphasis. It is clear that, year on year, the implementation plan indicates different actions and different directions. In my view, that is being used more than the strategy as the vehicle to reflect the changes that have come about as a result of the current recession.

Ms Alexander: We will look to the minister for clarity on whether strategy is for Government or for FiSAB, and on whether the current strategy stands or whether the implementation plan represents the current strategy. As financial services are our second-biggest industry, it is not inappropriate to seek guidance on what the relationship is between the Government and an industry that has been a beneficiary of £470 billion-worth of Government guarantees in the past 18 months.

I turn to the substance of the strategy. Yesterday, some of us had the opportunity to listen to John Varley give evidence to the Treasury Select Committee. He stated clearly that he felt that financial services would best be served by making big banks safer rather than by making them smaller. We later spent some time with Mervyn King, the governor of the Bank of England, who reiterated his very different position, which is that financial services would be made safer by having smaller rather than larger banks.

Given the significance of banking in Scotland and the scale of some of our banks, what is the view of FiSAB on that issue? Has it discussed whether our future would best be served by adopting the Varley view that we should make larger banks safer or by adopting the governor of the Bank of England's view that we should have smaller banks?

Mark Tennant: Forgive me, but we are straying into areas that are not matters for FiSAB. Whether we should make banks such as Barclays or the Royal Bank of Scotland into large banks or small banks is not a matter for FiSAB. It is a matter for two or perhaps three sets of people: the UK Government, the regulators and the board of the bank concerned.

Ms Alexander: Let me press you on another matter. UK Financial Investments Ltd told us in evidence that any disposal of its stake in RBS would be exclusively a commercial transaction. Last week, representatives of the accountancy profession expressed deep concern about the opportunities for advisory work in Scotland if functions were moved out of the country. Given the significance of not only the provision of services in Scotland but access to and the availability of advisory and other work for the financial services community, can we expect FiSAB at any stage to make recommendations to UKFI on the management of its stake in Scottish bank holdings? Is that in or out of your scope?

Mark Tennant: That question is somewhat different from your original one. The movement of corporate headquarters out of Scotland, which is what the accountancy profession was talking about, is something that we should all guard against as much as we can. Indeed, FiSAB certainly wishes to retain as many of the corporate headquarters in Scotland as it can. I am sure that the Scottish Government will make representations on that to the extent that it can and that SFE will play its part but, as I say, that is a different question from the question whether the banks should be broken up.

Ms Alexander: Did you make any representations to the EU when it was considering disposals under state aid rules?

Mark Tennant: No.

Ms Alexander: Have you made any recommendations to UKFI on the approach that you would favour if, for example, there was a takeover bid for the Royal Bank?

Mark Tennant: Such matters are simply not for FiSAB, okay? That is not what we are here for. As I made very clear at the beginning of the meeting, we are a communications group between the First Minister and the financial services industry on devolved matters.

Ms Alexander: So FiSAB would not take a view on a takeover bid for the Royal Bank.

Mark Tennant: I am sure that FiSAB might discuss it, but what you suggest is not within its remit. Its remit is to deal with devolved matters. Of course, as far as jobs are concerned, we will all want to make representations to ensure that Scotland retains its financial services industry and we will try to play our part in that. However, FiSAB as a body is not going to go out there and make public statements on what the Royal Bank should or should not do. That is a matter for the Royal Bank, the regulators and Parliament.

Ms Alexander: Is making representations to the EU on the solvency II directive a matter for FiSAB?

Mark Tennant: Solvency II is certainly a matter for SFE and we do have a view on it—

Ms Alexander: For SFE or FiSAB?

Mark Tennant: At my first meeting, I actually brought up not only solvency II but the alternative investment fund managers directive, on which Gavin Brown has very kindly provided a huge amount of help. We can carry out a lot of representation in Brussels, particularly on regulation, but we need to do that with the UK Government.

Ms Alexander: With respect, I am trying to establish what makes FiSAB's role distinct from that of SFE. Is it within FiSAB's remit to make representations on solvency II?

Mark Tennant: FiSAB is not there to do that; that is what SFE does. FiSAB is a communications group between the First Minister and the industry. It is not a body that makes representations. That is not what it is there for.

Ms Alexander: Does it make strategy for financial services in Scotland?

Mark Tennant: Well, as you have rightly pointed out, it already has, but it does so in the very broadest terms and where devolved matters are involved. We have to ensure that Scottish Enterprise is on our side and all the rest of it but, as I have said, we must keep ourselves to devolved matters and not get involved in matters that relate to the UK Parliament.

Ms Alexander: Given the complex world in which we find ourselves, the fact that so much public money has gone into supporting financial services and the live discussion about the future of Scotland's most important sector, I think that it is not unreasonable to press on these issues and to try to understand where responsibility for corporate governance lies. Indeed, it is wholly appropriate for parliamentary accountability. However uncomfortable these questions might be, we need to establish how responsibility is shared among Government, a trade body and FiSAB.

11:15

Mark Tennant: Wendy, I am not in the least bit uncomfortable. I am very clear about which are and are not devolved matters—that is where I sit. I can give you my personal view on whether we should break up the banks afterwards, but not here.

Rob Gibson (Highlands and Islands) (SNP): In the short time that we have and without going off on another fishing expedition, I want to ask about the FiSAB vision for the future of the banking sector in Scotland. Clydesdale Bank and HSBC have made commitments to organic growth, for example, and we have seen new banks such as Tesco Bank coming in. How do you envisage the structure of banking in Scotland in the future?

Mark Tennant: To some extent, it will follow the structure of banking in the UK. The first and most important thing is to welcome the Tesco Bank initiative, which has arrived here in Scotland. Benny Higgins, the chief executive, is a terrific guy and will do a marvellous job.

There are issues to do with the future of banking generally and the ability of newcomers to break into retail banking, such as free banking and all sorts of matters to do with economies of scale. What I would like to see—and I am sure that the committee shares this view—is a varied, competitive retail banking sector that serves small and medium-sized enterprises and large companies alike as well as individuals, to ensure that everyone in Scotland has access to good banking facilities, which is the point of microfinance. However, I am by no means convinced that that is the truth of the matter in the UK or, indeed, elsewhere.

I hope and pray that Tesco Bank succeeds; I am sure that it will. That will add another dimension to the situation. I have no idea what will happen with HSBC and Barclays, but they are clearly growing here, which is good, too. We will see a lot of competition. We will have to see what happens as far as the sales of RBS and Lloyds TSB assets are concerned—that is a matter for the market. All I hope is that as much competition is opened up as possible. Certainly, we should all welcome the Office of Fair Trading investigations into retail banking. Creating greater transparency is an issue across the financial services industry.

Rob Gibson: Does Jim Watson have anything to say on this?

Jim Watson: Yes. On the future for banking, like Mark Tennant we welcome the relatively new entrants to the banking sector, which we think will increase competition and reinforce the view that we still have a strong Scottish financial services proposition. The new entrants have put their money where their mouth is and have invested in Scotland so, from that point of view, we are delighted. From a task force point of view, too, it is great for us, because it gives us an opportunity to match those who are downsizing in the industry with those who are taking on people. We have already seen some success in that direction.

Rob Gibson: I want to develop that point a bit with Mark Tennant, who talked earlier about divestments. What is FiSAB's assessment of what would be in Scotland's best interest from the divestments?

Mark Tennant: FiSAB has not yet discussed that, but I suspect that it will come up at the next meeting.

Rob Gibson: What about what Jim Watson said about the development of new banks?

Mark Tennant: Yes, we will discuss that issue, for sure.

Rob Gibson: So the competition element will be discussed—that is good. We will be concentrating on the bad handling of the real economy by the banks, in particular the big banks—the duopoly that we have for small businesses. Can the 73 per cent penetration of the two biggest banks be dismantled in any realistic sense in the next 10 years?

Mark Tennant: As I said at the beginning, Rob, I am not an expert in retail banking—it is the one area in which I have not worked. I think that it will be difficult to reduce that penetration, although I hope that it can be done. Certainly, issues such as free banking and transparency need to be resolved to allow that to happen. Personally, I want transparency to increase in the industry—I think that SFE wants that, too—and I believe that that will allow penetration to be reduced. In my view, it is not a good idea to have that kind of penetration in any country—it is a matter for concern. However, if anybody can do anything about it, Benny Higgins can.

Rob Gibson: I am conscious that other members have questions.

Stuart McMillan (West of Scotland) (SNP): Some of the questions that I was going to ask have been posed by other members. Do either FiSAB or the task force have a role in promoting Scotland as a financial and banking sector throughout Europe and elsewhere in the world?

Jim Watson: Yes—not necessarily through the task force directly, but certainly through Scottish Enterprise and Scottish Development International. Scotland is very much open for business, and most businesses view consolidation as a central part of their agenda. That presents a threat to us, but it is also an opportunity.

We believe that we still have a first-class proposition in Scotland, and the time is right for a targeted promotional campaign, which has been discussed at FiSAB. I would describe it as a rifle-shot rather than a machine-gun approach—the promotional activities are targeted at particular audiences. We feel that promoting Scotland is vitally important.

Mark Tennant: SFE and FiSAB work closely with SDI, with which I had a meeting two days ago in London. We also attended the Euro finance week in Frankfurt. Our job would be much more difficult if it were not for Scottish Enterprise and SDI. They do a phenomenal amount of work around the world, particularly in Asia, but also in America.

There is now almost a stronger—albeit slightly smaller—force to attract people to Scotland than there is to attract people to the City of London. We will see what happens with TheCityUK, whose advisory board I sit on, but we are doing a damned good job. SE and SDI are doing a very good job in helping us to promote Scotland, and one of my roles is to ensure that I do as much of that as I possibly can.

Stuart McMillan: Mr Watson mentioned the campaign. Can you make any more information on that or promotional material available to the committee when it is ready?

Jim Watson: Yes—in fact, we have just updated some of our proposition material and sent it to members of FiSAB. We will ensure that the committee receives copies of that material.

Mark Tennant: Interestingly enough, SFE has been asked by the UK financial world to write the paper for the UK as a whole on how the fund management world should interface with China. That is being done in Scotland by Scotland, and it leverages on what we already know here.

The Convener: We will return to that area in our next inquiry, which is on international development.

I ask you to be honest and frank: has Scotland's reputation as a financial services sector been damaged by the fact that two of our largest institutions were among those that went down? If so, what else do we need to do in Scotland to try to restore that reputation?

Mark Tennant: The damage that has been done appears much greater to us in Scotland than it does to those in the outside world. There has been some damage to the UK's reputation; we should remember that Royal Bank of Scotland was an international bank.

If you go to America, and certainly if you go to Hong Kong, Korea or Singapore—from which I returned three months ago—you find that the reputation of the Scottish financial sector has not been damaged at all. I assure you that the image of Scotland has not been tarnished—to the extent that it has at all, the damage is relatively small. We are much closer to the situation here, but for those looking in, it appears to be nothing like as bad as we think it is.

The Convener: We were in London yesterday and at least one person to whom we spoke said that the Scottish financial sector is being a little blind to the potential damage to its reputation. Is there a reasonable possibility of that?

Jim Watson: From our conversations through the task force with a number of the big banks, we have evidence to suggest that there has been a bit of an impact on the reputation of financial services organisations in Scotland, of which the banks are aware.

As Mark Tennant said, the further from Scotland one goes, the less of a problem that becomes. It is more likely that we are experiencing reputational damage within the UK. To respond to Stuart McMillan's question, that is part of the reason why we feel that we need to get out there and promote Scotland again, to help to repair some of that damage. However, I do not think that the damage is anywhere near as bad as some people are suggesting.

Mark Tennant: Where we have an issue is internally, particularly in schools, colleges and universities; there might be a view there that the financial services industry is not the greatest place to work. That is a concern. We need to get out there and say that we are not all charlatans and brigands, despite what some people may think.

The Convener: I will not comment on that at the moment.

Lewis Macdonald (Aberdeen Central) (Lab): Earlier, Mark Tennant drew a fairly clear line around what you think your responsibilities are and are not—fundamentally, they relate to the devolution settlement. One of the points that has been put to us is that although the Royal Bank of Scotland is an international institution, the fact that it, HBOS and Northern Rock were early casualties in the financial crisis might have had something to do with their being located outwith the City of London. Does that view have any resonance within FiSAB?

Mark Tennant: None at all. You said that they were early casualties. Northern Rock was the earliest of all casualties. The reasons for what happened to Northern Rock and for what happened to RBS are very different. In my view, they are not at all related.

Lewis Macdonald: Is there an issue with the level of engagement of any of the tripartite authorities outwith the City of London, whether in Newcastle, Edinburgh, Glasgow, Aberdeen or Perth?

Mark Tennant: None at all. Both the FSA and the Bank of England have operations and people up here. It does not matter whether you are located in Leeds, Bournemouth, Plymouth, Edinburgh or Thurso; the level of communication is just as strong. I do not believe that the fact that RBS was located up here made any difference at all.

Lewis Macdonald: Colleagues have already raised issues about competition. Is there any issue with the Office of Fair Trading's awareness of or sensitivity to issues here?

Mark Tennant: There are issues of competition—UK-wide, not just in Scotland—that need to be sorted, but I do not believe that Scotland is in any way disadvantaged because it is, in a sense, remote.

Lewis Macdonald: In considering such issues, is the OFT, or the Competition Commission, taking enough heed of the regional markets as opposed to the UK-wide market? The level of duopoly for small businesses is significantly greater here than it is in England and Wales. Does the OFT need to be more conscious of that?

Mark Tennant: In all its work—whether we are talking about supermarkets or banks or anything else—the OFT takes account of regional penetration. Obviously, the more remote the place, the more difficult competition is. The ability of RBS, Clydesdale and the Bank of Scotland to compete in Thurso is somewhat limited, if you get my point. That is true of the supermarkets, too. As far as I know, only Asda is in Thurso. Tesco and Safeway have made no attempt to go there. In the more remote areas, the problem is much bigger. Banking in remote areas is an issue generally, but I do not think that it appears before the OFT.

Lewis Macdonald: That is helpful.

The evidence that we have heard from banks and about banks has highlighted weak corporate governance and a failure of non-executive directors to ask the right questions at the right time. We have heard in evidence from other parts of the financial services industry in Scotland, such as insurance and asset management, that they have different cultures, corporate governance and approaches to these things, which is part of the reason why they did not find themselves in the same level of difficulty. Does FiSAB in any way offer an opportunity for mutual learning and to combine the best features of different parts of the sector?

11:30

Mark Tennant: It would be a pity if we pursued that only in Scotland. There are other companies to learn about corporate governance from, in England and elsewhere. To be frank, there is no one cause of this crisis—there was a plethora of causes, and there was a failure on the part of all sorts of organisations and agencies, including banks, regulators, non-executive directors and fund managers who owned banks. There was a failure of the system—a systemic failure.

Lewis Macdonald: Is corporate governance a potential agenda item for discussion or an area on which you might take a view?

Mark Tennant: I doubt it.

The Convener: Still on corporate governance, the question has been raised whether the gene pool for non-executive board members is sufficiently deep. Is there anything that FiSAB might be doing to ensure that there is an adequate pool of people who can be trained up—

Mark Tennant: The answer is no, we have not addressed that. There is a limit to what FiSAB can do, as it meets only three or four times a year—and I do not think that it should meet more often. It needs to concentrate on the subjects that really matter. That is a very good point, however, and I will take it away. We have not worked on that, but we probably should.

Stuart McMillan: The subject of bankers' bonuses has been in the media quite a lot in recent months.

Mark Tennant: No surprise.

Stuart McMillan: Does FiSAB have any opinion on the matter? Has it discussed bonuses and what not?

Mark Tennant: To start with, that is not a subject for FiSAB. FiSAB could sit and have discussions seven days a week if it were to cover all the issues that Wendy Alexander and you have suggested, and we would never cover the issues that we actually mean to cover. Any such body must focus on the issues at hand—the issues that it is meant to deal with. There simply is not the time for peripheral discussions, nor are we the right body to have such discussions—we are certainly not the right body to opine on bankers' bonuses. Some of us are conflicted, apart from anything else.

Christopher Harvie (Mid Scotland and Fife) (SNP): We spoke yesterday with a gentleman who, I imagine, is in a good position to know about this subject. He said that what has hit us over the past couple of years is far worse than what happened in 1929. As we discussed, there has been a shift away from a market-led system towards far greater regulation, inevitably.

FiSAB meetings have been mentioned. Adair Turner said that he is working seven days a week for the FSA, having been appointed on a part-time basis. I agree that we are moving into an era of more regulation. Where do you see the Scottish financial system fitting in under a much more regulated financial system?

Secondly, is there a possibility—to be set against the inevitable impact of divestment, which we have not gone into at all this morning—that some areas of regulation will be devolved not just in a Scottish sense, but in a British sense? I am referring to the management of residual toxic banks in Edinburgh, for example. Can we bid in areas like that?

Mark Tennant: Am I allowed to give a personal opinion?

The Convener: Indeed you are.

Mark Tennant: This cannot be FiSAB's opinion or SFE's opinion, but after 38 years in this area, and having been through two crises, I can give you a personal opinion. My concern is how much time we have, as that was a very big question.

We have to understand that the roots of the present crisis go back to 1971, although that appears not to have reached the press yet. In 1971, we left the Bretton Woods system. I am not suggesting that we go back to Bretton Woods—that was absolutely the right decision at the time. Two things followed. Margaret Thatcher abolished exchange controls in 1979, and we had the big bang in the City in 1986.

Those three events heralded, for the very first time in the world, totally free movements of global capital. We had never had that before. The transmission mechanism was the global banks. The global banks and global transmission created enormous wealth—and you can forget the bubbles. If you do not believe that, you should go to China, India, Taiwan or other places in the far east, or indeed to many places in South America.

Huge wealth was created by that mechanism. Unfortunately, we had global banks and domestic regulation. If we go back a little further, Bretton Woods was designed at the Mount Washington hotel in 1944, during the war, by two great economists, John Maynard Keynes and Harry Dexter White, and others, who sat in that hotel for a long time. If members have been there, they will know that it is a bit like a Blackpool hotel—all of the wallpaper is falling off the walls—so it must have been quite uncomfortable in 1944. Keynes and White defined a new world order that created the World Bank and the International Monetary Fund. We have failed, collectively and globally, to recognise that a new world order was needed post-1971 and that global transmission required some form of co-ordinated international regulation.

My second point relates to Wendy Alexander's question, which I will answer on a personal basis. I do not believe that the remedy is a return to Glass-Steagall or to John Kay's narrow banks—those do not work any more and would not necessarily solve the problem. The problem is in three parts, which are interconnected but somewhat separate.

The first issue is protection of the retail depositor, which is critical. The problem is relatively easily solved, but no one seems to have produced the solution. Quite simply, it is for the retail depositor—however defined—to be a preferred creditor under a bank bankruptcy. Given the construction of banks' balance sheets, it is inevitable that, in any bankruptcy, the retail depositor will get paid out if they are a preferred creditor. That makes the Government's insurance scheme a liquidity insurance scheme, not a solvency one, which means that it is hugely less expensive. That solution is buried at the bottom of John Kay's wonderful paper—it is the only part of the paper with which I agree—but he has not brought it forward.

The second issue is too big to fail. The problem is not too big to fail, but too interconnected to fail, which is a different prospect altogether. The problem was that the transmission system crashed, a bit like the grid when there is a short circuit in a power station. Lehman Brothers and Northern Rock were not big banks; in world terms, both were relatively small, if we compare them with JP Morgan, Citibank or others. The problem was not size.

We can deal with interconnectivity in two ways. First, we must find a way of dealing with the clearing of what people call toxic waste. In fact, it was not toxic waste but weapons that were put in the hands of those who should not have had them; if you put morphine in the hands of someone who is not qualified to use it, you will get a disaster. That is what happened. We must find a way of customising a lot of derivatives and putting them through central clearing agencies that are properly capitalised. A big question is, who is big enough to host such a central clearing operation? That is a major political issue at the moment that is not being and should be debated. If we had been independent, it would have been fairly easy to determine whether we were big enough to host banks; from Iceland’s perspective, the answer was obvious. There is a problem for the UK. The idea that China and America are the only countries that can have big banks is not a good one politically—we must deal with that.

Secondly, we must deal with the capitalisation of banks. A large amount of capital must be attached to those banks that are holding things that are not put through central clearing parties, so that they are profitable only when risk is properly taken into account. Basel III or IIIa will address the question of the capitalisation of banks. Internationally—not just in Scotland—we have not operated on a capital base that is commensurate with the risk that has been taken. That issue came home to roost. We must be careful, because if we start to make the banks recapitalise hard, lending will be constrained and the recession will increase. How we deal with that will be a tough decision.

The third issue—this is very much a personal view—is that we must examine the conflicts of interests that exist in the City of London and the international financial community as a whole. We need to resolve some of those conflicts. Incidentally, if we sort out banks’ capital, we will sort out the bonus issue to some extent.

I have offered a personal view of how we should move forward. It is not necessarily shared by any of my colleagues—it is the view of Mark Tennant, after 38 years in the sector and having been through two crashes. There is no silver bullet. I am sorry that my answer had nothing to do with Scotland and related entirely to financial systems.

The Convener: It is interesting to hear your views, based on 38 years’ experience. I am afraid that our time is running out, as we have the cabinet secretary to come.

Christopher Harvie: I have a last brief question. What tends to vanish in discussion of financial services is the productive economy below that. We have two huge challenges before us: renewables and carbon capture in the North Sea, which is a mega challenge; and the domestic challenge of retrofitting an extremely inefficient housing stock, so that we can have a much reduced carbon imprint, which comes down to small-scale lenders and borrowers. The two challenges go together and seem to have a necessary location in Scotland, as part of the organisation of a productive economy. What changes are needed to gain that?

Mark Tennant: We are going outside my capabilities. My knowledge of renewable energy and how it should be financed is not terribly great. Does your question relate directly to how we should promote the non-carbon economy?

Christopher Harvie: Scottish finance managed efficiently to promote North Sea oil exploitation in the 1970s and 1980s. Something similar will be required for the low-carbon economy, with potential gains in that area. How do you plan to set about that?

Mark Tennant: As you probably know, quite a lot of money is already going into the area. One difference between the oil industry and the renewables industry is that the pricing mechanism for renewables is largely reliant on Government policy, which was not the case with oil—the pricing mechanism for oil was reliant on the market. We need to get a market in renewables that is sustainable and in which carbon trading and capping are largely international and properly controlled. Some parts of the carbon market are not properly controlled; quite a lot of carbon offsets are by no means real. The situation is improving, but not a great deal. Until we understand how government works in the area, how Kyoto translates to the period between 2012 and 2020, and the extent to which carbon emissions will be restrained, it will be difficult to put up any sustainable banking proposition. Again, that is a personal opinion. I do not know whether my comments are helpful, but there is a great deal of uncertainty on the issue.

The Convener: Time has beaten us. I thank Jim Watson, Gordon McGuinness and Mark Tennant for coming to give evidence to us. I suspend the meeting while we change panels.

11:43

Meeting suspended.

11:48

On resuming—

The Convener: I welcome our second panel, which consists of the Cabinet Secretary for Finance and Sustainable Growth and his supporting cast. In a moment, the cabinet secretary will introduce his team and make some opening remarks, but he needs to get away by 5 past or 10 past 1. I ask members to keep questions as tight as possible, so that we can get through everything that we need to get through.

John Swinney (Cabinet Secretary for Finance and Sustainable Growth): I begin by introducing David Wilson, who is the director of the enterprise and energy directorate of the Scottish Government, and Gary Gillespie, who is the deputy director of the office of the chief economic adviser.

I welcome the committee's inquiry into the banking sector in Scotland. The financial services sector remains one of the most important sectors of our economy. During a difficult couple of years for the banking sector, the fund management and insurance sectors have done extremely well. Although some significant structural changes have taken place in banking, we have seen the emergence of new players in the sector such as Tesco Bank, which are continuing to contribute to its development. The major banking institutions of the Royal Bank of Scotland and Lloyds Banking Group have gone through a significant transformation during that period.

It is essential that we continue to maximise the opportunities for development of the financial services sector in Scotland. Undoubtedly, we need to learn lessons from past experience, but we must also ensure that we take the industry forward in an effective fashion. There is a clear need to regulate properly and co-operate internationally to ensure that we never again have to see the Government interventions that have had to be made in the past couple of years.

Another significant issue that concerns the Government in relation to the financial services sector, and particularly the banking sector, is access to finance. Yesterday, I published an updated report on our access to finance survey. I appreciate that it was published in close proximity to the committee's meeting, but I wanted to publish it before my appearance today. The report has been updated to reflect changes in conditions during the past six months. It focuses principally on the experience of the SME population in Scotland. The survey in March 2009 showed increased demand for finance by SMEs, an increase in rejection rates by banks and particular difficulties for specific sectors of the economy in obtaining finance. That was a particularly acute period of difficulty for the banking sector. The November survey showed a welcome improvement in a number of areas—in particular, less reluctant borrowers and a fall in the outright rejection rates for SMEs. However, SMEs are still concerned about the cost of finance and their ability to secure the full amount that is sought. Obviously, there is a clear correlation between the cost of finance and demand for it. Offers of finance might be available, but if it is unaffordable, that raises significant issues for SMEs.

I am happy to discuss the updated report with the committee. If there are issues that the committee has not had time to consider, I will be happy to provide further information in due course.

The emerging evidence from the survey suggests that there is an adjustment process for the whole economy that is reflecting new conditions within the banking sector and a new market for finance. The Government will continue to monitor that situation as we look at the analysis and work with other partners to ensure that all aspects of the Scottish economy can gain access to the appropriate levels of finance to support their business activities.

I am happy to answer any questions.

The Convener: Thank you for those opening remarks. What are the Scottish Government's views on the impact of the financial crisis on Scotland's real economy and, more specifically, on the financial sector itself? Can you give us details of any of the surveys, analysis and research that you have done on those issues?

John Swinney: On the analysis of the Scottish economy, as I am sure you know, the Government looks at a range of indicators and assesses the performance of the economy on a regular basis. Our chief economic adviser, Dr Goudie, whom I believe has already given evidence to the committee, provides the Government with regular updates on many aspects of the data, and that analysis is published frequently to provide information on the Scottish economy.

On the experience, it is clear that the financial crisis has been a significant contributor to the wider economic difficulties that we have faced in the past 18 months. We are beginning to emerge from that period of recession, and a critical factor in assisting that journey is the availability of finance to support companies that wish to undertake appropriate investment in that scenario. Access to finance is fundamental to encouraging the investment decisions that are required to help us out of economic recession, hence our focus on the access to finance survey.

As I said in my opening remarks, the performance of the financial services sector has been divided. The banking sector has experienced real difficulties and challenges and it is now going through a period of restructuring and recovery. In among all that, a significant amount of good progress has been made by the fund management sector, the insurance sector and the pensions sector. There has been a very positive level of business activity in those sectors, which is reflected in a general assessment of the condition of the sector. Clearly, we are at an important stage in the journey out of economic difficulty, and the Government believes that the financial services sector has a significant contribution to make to our continuing that journey.

The Convener: On the general economic recovery issue, the release of GDP statistics for Scotland lags a bit behind the release of similar statistics for the UK, which showed a marginal growth of 0.1 per cent in the past quarter. What indications do you have of the likely situation in Scotland over the past quarter? Has Scotland emerged from the recession yet, or do we still have some way to go?

John Swinney: My view throughout the period has been that our performance on GDP has largely matched the UK's performance over the past 18 months. My expectation and hope, therefore, is that the performance of the Scottish economy has mirrored the performance of the UK economy in quarter 4. I would like to say that it has bettered it, but I suspect that, when we have those data later in the spring, we will see that it mirrored the UK economy in quarter 4. Why do I say that? A number of different, pretty reliable indicators of the journey into recession—particularly the purchasing managers index, which charted the steps into recession—have given us a consistent picture of improving conditions since the middle of last year. On the basis of those data, I am optimistic that Scotland moved into recovery in quarter 4, and we obviously want that progress to be sustained beyond that period.

The Convener: Let us move on to the financial services sector, which is very important for the Scottish economy; that is the reason for the committee's inquiry. Given that the strategy for the financial services sector was set in 2005, has the Government considered reviewing the strategy to take account of the financial crisis that we have experienced?

John Swinney: I would not want the committee to believe that the strategy was fixed in 2005 and that its details have never been revisited. FiSAB looks at an annual programme of activity to support the development of financial services in Scotland, which has taken into account the circumstances that we have experienced. In recognising the sector's importance to the Scottish economy, it is fundamental that we ensure that the sector is appropriately supported and that there is training, education and learning to support its development. Those are all important principles of the operating initiatives that are taken forward by FiSAB annually. I acknowledge that the circumstances around the industry have changed, but its significance and contribution to the Scottish economy mean that it remains a high priority for the Government. The work that is undertaken to review the interventions that we make annually reflects that significance and the adjustment that has had to be made in the different circumstances that we face.

The Convener: Would you say that, within that, there have been changes in emphasis in the development of the strategy? Which particular sectors in the financial services industry are we concentrating on now?

John Swinney: There is no sector that I would say is not important or worthy of attention. However, at different stages, some sectors will be able to make a greater contribution and deliver greater amounts of growth than at other times. For example, even during the difficult period that we have had, we have had a fairly buoyant pattern of activity within the fund management sector. So, although there are wider difficulties for financial services, some areas of the sector are still able to prosper. The Government's interventions and the approaches that we take are designed to support that development and to tackle any inherent weaknesses that we find in the economy.

12:00

Rob Gibson: The paper on access to finance in the real economy in Scotland raises an issue that is central to our recovery. The report that you have presented is still very worrying. On the banks being prepared to make loans now, we know that two large banks are dominant, as they have about 73 per cent of the market in Scotland. Has the Cabinet discussed the vision of how banking should respond to the needs of our small and medium-sized enterprises in the future?

John Swinney: Yes. The access to finance survey is an essential component in marshalling what the Scottish Government can do to influence that wider market proposition. We are obviously in a very different landscape now with regard to the operation of those two principal banking institutions than we have ever been in the past, so the contact points for trying to influence that agenda are somewhat different.

Ministers have regular dialogue with the leadership of the whole Scottish banking sector: over the past 12 months, the First Minister and I have met the leadership of all the banking institutions in Scotland on a number of occasions in order to, essentially, marshal the argument that

Mr Gibson has made about the importance of lending and the role that it can perform in supporting economic recovery. That has been a staple in our conversations with the banks.

There is also a need for us to make clear our views to the United Kingdom Government and to UKFI, which acts on behalf of the UK Government in the dialogue with the banks. I have met the leadership of UKFI and we obviously remain in dialogue with the UK Government on the direction, advice and guidance that it provides to the banking sector, in which it has a significant interest. I made available to the Chancellor of the Exchequer the access to finance survey and I will make the update available to the chancellor to assist in these discussions.

A couple of weeks ago, I had a very helpful conversation with the Chief Secretary to the Treasury, along with my counterparts in Wales and Northern Ireland, who expressed to the chief secretary many of the sentiments that I am expressing to the committee about the importance of ensuring that the banking institutions take the appropriate lending approaches. The chief secretary responded very positively and indicated a willingness to engage the devolved Administrations in the formulation of guidance that the UK Government gives to UKFI and to the banking institutions. That type of discussion is helpful.

A number of different conversations now take place to try to influence that agenda, but the outcome that we are trying to achieve is a satisfactory flow of lending in the Scottish market, whether for business or domestic purposes. The access to finance survey shows that there are still some live issues.

Rob Gibson: On those remaining issues, the dominance of RBS and Lloyds TSB clearly has an effect on people, because, although they say that they are prepared to lend, it is obvious, given the way that people are using overdrafts, credit cards and so on in SMEs, that they are having grave difficulty in getting the money they need just to survive. Business is telling us that there needs to be a change in the way in which the lending system operates. You said that you have had conversations. In respect of your vision for the shape of banking, as I asked Mark Tennant on the previous panel, can competitors break down the duopoly to give people a better choice in Scotland? How does the Government see that coming about?

John Swinney: The Government's view on the central question of whether there should be more competition in the banking market is that there should be.

Mr Gibson's second point was about whether competitors can break down the duopoly. There is clear evidence that they can. I cannot marshall the data in front of me at the moment, but I know from my dialogue with the business community, in different parts of Scotland that, when other players have become involved in a local marketplace in which they have previously not been particularly active, and have offered competitive propositions, that has generally led to an opening up of the market, not just by the new providers, but by existing providers in different localities. The message on competition works in that respect.

It is clear that opportunities arise from the European Union's Lloyds and RBS divestment requirements. The Government certainly wants to see increased competition in the Scottish marketplace as the outcome of those divestments and will, obviously, encourage that process.

Rob Gibson: How can you encourage a range of competition from the divestment process?

John Swinney: We have considered the European Union's divestment proposals that have been agreed by the banks and we have assessed consequent opportunities from restructuring that would be beneficial to the Scottish marketplace. The Government will encourage market interest in different propositions and the development of market opportunities that would be beneficial to Scotland. We have done the desktop exercise of considering the options and have begun to talk to individual institutions about interest in taking up opportunities. Obviously, that is an active aspect of the Government's agenda.

Rob Gibson: You talked about discussions with UKFI. Our inquiry suggests that UKFI has not focused on the needs of the Scottish economy, but on the need to get RBS, for example, on to a sound footing. There seems to be a conflict in terms of our requirements. What influence can we exert on UKFI so that it is active for our economy? It appears from its evidence and that of others that it has not been so.

John Swinney: Ultimately, we can make a case to UKFI and United Kingdom ministers. We have no controlling interest in UKFI, but we certainly have an interest in what it does. That is clear. Our dialogue with the UK Government is important in that respect. That is why I welcomed what the Chief Secretary to the Treasury had to say during the finance ministers' quadrilateral meeting a few weeks ago. There is a clear dichotomy between the recovery of the financial position of banking institutions and the recovery of the economy, and unless we get interventions operating in happy harmony, there is a danger that the economy will not develop as much as it could.

The Convener: I would like to press you a little further on the nature and shape of the banking industry in Scotland in the future, given the divestments. It can be argued that, with the divestment of the Lloyds TSB branch network, we have a once-in-a-generation opportunity to change the nature of the banking industry in Scotland. Essentially, the divestment of that network only takes things back to where they were before the merger.

Does the Scottish Government have a vision of how it would like the banking sector to develop in Scotland to ensure that there is competition not just in terms of the number of institutions but of the types—mutuals and non-mutuals, for example—and if so, should the Government, Parliament, and FiSAB be working together to decide how to go about creating opportunities for the new vision for Scotland's banking sector?

John Swinney: The committee's input and inquiry will be helpful to the formulation of such a position. The Government wants to ensure that we get out of the divestment approach more active players in the banking market in Scotland. The committee's input to the process and, I hope, a debate in Parliament will help us to refine and develop that. Of course, the divestments that the European Union requires are to take place over four years, so you are right to say that there is an opportunity to shape the agenda as effectively as we can.

Ministers will discuss the subject with FiSAB with a view to securing the industry's input into the process. The one caveat that I would apply is that, when we come down to individual institutions, certain issues become very commercially sensitive, so I put it on the record that we will have to consider that during any dialogue. Ministers are keen to encourage more players and to ensure that the Lloyds TSB divestment gives us the opportunity to secure another headquartered institution in Scotland; a banking licence goes with the TSB network. We will continue to pursue other opportunities, and the committee's input will be very valuable.

The Convener: I want to press you a bit further. At the moment, it is most likely that Lloyds TSB will be taken over by another large banking institution somewhere in the world. That will not really change the types of player that we have, and it will not mean opportunities for more mutuals, for example. Should we be encouraging the development of different types of bank, not just different owners?

In America, no bank can own more than 10 per cent of the market. In Scotland, two banks own 75 per cent, or more, of the market. Even after the divestments, there will still be banks that own 30 per cent to 40 per cent of the market. Is that healthy? Should the UK and Scotland look at ways of reducing the market share that any one bank can have in order to ensure more competition?

John Swinney: There are clearly opportunities for a different type of banking structure in Scotland in the aftermath of our difficulties. I do not think that there is any impediment to that happening. The convener painted one scenario in which a larger institution could acquire some of the divestments, but that does not need to be the case. There are other possible scenarios.

It will also be interesting to see consumers' attitudes. I certainly detect a desire for what has been referred to colloquially as boring banking, and I do not doubt that there is an appetite for that within sections of the market. People simply want to be able to rely on financial institutions without the uncertainty that they have faced during the past 18 months. I think that there is no impediment to the realisation of such an aspiration in the period ahead.

I turn to the appropriate level of business to be controlled by one institution—of course, the Office of Fair Trading has a significant role to play in this respect. As I said to Rob Gibson, it is in the interests of the Scottish economy that there is maximum competition because that will ensure that vibrant banking propositions are available across the sector in Scotland.

12:15

The Convener: At the time of the Lloyds takeover of HBOS, when competition requirements were waived, did the OFT not indicate that it wished to keep under review the banking market for retail and small and medium-sized enterprises? In its evidence to committee, the OFT said that it has not done anything about that since that time. Has the Scottish Government made any representation to the OFT to encourage it to examine competition issues in Scotland?

John Swinney: David Wilson will give the detail on that.

David Wilson (Scottish Government Enterprise, Energy and Tourism Directorate): We have had a number of informal discussions with the Office of Fair Trading on the issue. Clearly, in the report to which you referred, which was undertaken at the time of the proposal for the merger of HBOS and Lloyds, the OFT identified that the merger would have a negative effect on competition, in particular because of the nature of the Scottish market, and that it would have to return to the matter.

In its evidence to committee on the discussion since that time, I think that the OFT was saying that now is a very challenging time to assess the precise impact of competition because the market is going through such structural change. It is inevitable that the OFT will return to the issue. We would support it in a review of how the changes that are under way can incrementally improve competition from the current base that is the result of the merger.

The Convener: Can you clarify that there have been representations to the OFT at official level, but no formal ministerial representation?

John Swinney: That is correct.

Ms Alexander: Given that we now have the second access to finance survey, will you request formally from the competition authorities that they initiate an investigation into access to finance for businesses in Scotland? You have the powers to do so.

John Swinney: The point that David Wilson made on the degree of change in terms of the restructuring that is going on in the marketplace is an important one. Clearly, we have an agenda of different interventions that the European Commission required in relation to the role of RBS and Lloyds. Obviously, that will have further significant structural effect on the banking market in Scotland.

As I explained to the convener, the Government wants to take every possible step to ensure that a greater competitive proposition within the market comes out of the process. It is an active process; it is under way. There may be a role at some stage for such an investigation to be undertaken, but the degree of change in the market at this particular time suggests that it is important to get the correct outcomes in encouraging competition from the process, and then to consider such questions.

Ms Alexander: Is the Scottish Government in favour of there being a Scottish financial services authority?

John Swinney: There is no requirement for such an authority within the structure of the United Kingdom: financial services issues are reserved to the United Kingdom Government.

Ms Alexander: In June, *The Daily Telegraph* reported:

> "Mr Swinney said that he wants regulation of Scottish financial services to be devolved north of the border."

Is that still your position or have you changed your mind since June?

John Swinney: The Government's position is that we recognise that financial services regulation is currently a reserved function in the devolution settlement and that as a consequence such issues are dealt with on a UK basis.

Ms Alexander: I am asking whether you and the Scottish Government are in favour of the devolution of financial services regulation in Scotland. [*Interruption*.]

John Swinney: What I said in my answer was that in the current structures of the UK, financial services regulation is a reserved matter, which is therefore handled on a UK basis.

Ms Alexander: Do you want financial services regulation devolved to Scotland or not? Yes or no? It is an easy question.

John Swinney: Clearly—

Ms Alexander: You told *The Daily Telegraph* in June that you wanted a Scottish financial services authority. Have you changed your mind? [*Interruption*.]

John Swinney: It is clear that my aspiration, as a Scottish nationalist who wants an independent Scotland, is for such issues to be controlled by the Scottish Parliament. However, the issue for me now is that we operate within the devolved structure in the UK, and those powers are reserved to and retained at UK level.

Ms Alexander: In your devo max proposal, do you still favour a Scottish FSA?

John Swinney: Devo max is not the position of the Scottish Government; the Scottish Government believes in independence—that has been my position for the past 30-odd years. What is important is that we have in place the regulatory arrangements that are appropriate to, and suitable for, the needs of the financial services sector in Scotland.

Ms Alexander: Are you saying that in the current constitutional arrangements you do not want financial services regulation to be devolved to Scotland?

John Swinney: I am simply articulating the fact, as I see it, that just now—

Ms Alexander: I am asking you for your policy position. Do you want financial services regulation devolved to Scotland? [*Interruption*.]

John Swinney: I am a Scottish nationalist, who believes in Scottish independence and therefore in having such powers at the behest and control of the Scottish Parliament. That is my aspiration.

The Convener: Will everyone check that their mobile phones are switched off? One is interfering with the sound system.

Ms Alexander: Can anyone else secure greater clarity on whether Mr Swinney holds to his position of wanting a Scottish financial services authority? Tripartite regulation and its future are the centrepiece of the debate on the future of financial services. Does the Scottish Government favour a Scottish FSA? Is that something that you will ask for?

John Swinney: That takes us to the wider question about how the debate on financial services regulation will conclude. I accept that there are wide questions about financial services regulation, because of the nature of financial services products, instruments and activities. Much financial services activity in Scotland has a global reach. Therefore, the debate on regulation will involve all levels of governance—Scottish, UK, European and global. In that context, we must ensure that we have regulatory arrangements that are appropriate in the structures, conditions and circumstances that emerge. A very active and live debate is under way.

Ms Alexander: Your position in June was that Scotland within the UK would be better served by a Scottish financial services authority. Is that still your position?

John Swinney The important point, which I have just highlighted, is that there is an on-going debate about whether regulation with regard to the broad reach of financial services interventions is most appropriately sited at Scottish, UK, European or, indeed, global level. As the UK Government itself has recognised, we have to be careful that we do not end up with levels of regulation that confuse the ability to regulate effectively across markets. That is a very real danger.

Ms Alexander: Can I raise one more issue, convener?

The Convener: Briefly. Other members need to get in.

Ms Alexander: According to information that it has provided to the committee, SPICe has estimated that of the £753 billion of public money that the National Audit Office has said has been at stake over the past 18 months, £470 billion relates to RBS and HBOS. That is in excess of three times Scotland's gross domestic product, even if we were to receive in excess of 80 per cent of the oil revenues. How would an independent Scottish Government have been able to provide undertakings of such a scale?

John Swinney I think that the key point is contained in December 2009's pre-budget report, in which the Chancellor of the Exchequer estimated that the ultimate cost of UK Government support to address the difficulties in the financial services sector would be £10 billion. We feel that that figure most captures our response to the question of the real level of exposure to, and the real effect of, the difficulties in the sector.

Ms Alexander: Perhaps your officials—or, indeed, you, cabinet secretary—could comment on the fact that the National Audit Office has put a figure of more than £750 billion on the undertakings that have been provided and that, according to SPICe's estimate, £470 billion relates to RBS and HBOS. With respect, my question is not inviting speculation about what might be the figure X years down the line. Do you accept the NAO's claim that the undertakings that have been extended amount to more than £800 billion and do you believe SPICe's estimate of £470 billion for the portion that was offered implicitly to RBS and HBOS?

John Swinney I have not considered the methodology used in the SPICe analysis—

Ms Alexander: Will you write to us on that?

John Swinney I certainly will. However, the fundamental point is, as I said in my first response to Wendy Alexander's question, that the chancellor revised down the UK Government's possible exposure to risk in all this. If my memory serves me correctly, between the budget in April 2009 and the December pre-budget report, the figure was revised down to £10 billion from a range of £20 billion to £50 billion. That analysis shows clearly the potential long-term impact of the UK Government's intervention over the past 18 months.

Ms Alexander: So you think that a Scottish Government would have been able to extend to RBS and HBOS an implicit guarantee of the order of magnitude of £470 billion.

12:30

John Swinney: The question relates to the financial health of countries and their ability to provide assurance. I cite—Wendy Alexander will be familiar with this—the comparative experience of countries similar to Scotland. Other oil-rich countries such as Norway have been able to give significant financial assurance because of the prudent management of their resources over a long and sustained period, which has been singularly absent from the approach of United Kingdom Governments over many years. We would undoubtedly be in a position to provide that certainty. When we consider the information that the chancellor has put in the public domain, having revised his estimates of the cost of intervention down to £10 billion from between £20 billion and £50 billion in the space of only a few months, we get a sense of the potential long-term impact.

Ms Alexander: You raised international comparisons, and I heard you say that the Scottish Government would undoubtedly be able to provide that certainty. Will you comment on the SPICe figures that show that Scotland has a very oversized banking sector? In Ireland, the assets of the largest three banks were a mere 2.6 times gross domestic product in 2008; in Iceland, they were 7.7 times GDP; and, in Scotland, the assets of the RBS and HBOS were 21.6 times GDP. How could we undoubtedly provide that certainty when our banking sector approached 10 times the ratio in Ireland and more than double that in Iceland?

Have you had a chance to consider those issues? The figures speak to whether we have an oversized banking sector in Scotland. Even post-disposal, the multiple would still be more than double the ratio in those other countries.

John Swinney: That is a truly remarkable line of argument. If she took it to its logical conclusion, Wendy Alexander would be handing out redundancy notices to thousands and thousands of bank employees in Scotland because she believes that the banking sector is somewhat oversized. I take a fundamentally different view: over the past 300 years, Scotland's financial services sector has grown significantly and contributed enormously to Scotland's economic wealth. Unlike Wendy Alexander, I have no aspiration to shut down banking institutions and make bank employees redundant, which is the logical conclusion of the question that I have just been asked. I simply offer that to the committee as a fundamentally different view of what our aspirations for Scotland's banking sector should be.

Ms Alexander: I take it from that that you are not in favour of reducing the RBS balance sheet, as proposed by the UK Government. I thought that you were in favour of the EU proposals.

John Swinney: I am not in favour of handing out redundancy notices to bank employees, which seems to be the logical conclusion of Wendy Alexander's question.

Ms Alexander: No, the question that I am probing is whether Scotland can support a banking sector with an independent bank when its assets are 21 times—

John Swinney: My argument is, as I have said, that we would be able to provide adequate and appropriate support to institutions. Equally, there is no argument for axing bank employees in the fashion that Wendy Alexander is talking about by wishing upon us a reduction in the size of Scotland's banking sector. I find it a most curious proposition to be advanced at the committee.

Ms Alexander: No, that is deliberate obfuscation on your part of whether an independent Scottish bank could support a banking sector whose assets were 21.6 times GDP.

John Swinney: Wendy Alexander has a difficulty because she wants to single out two years of financial performance and suggest that that is the norm. I point to the 300 or so years of financial performance that have contributed massively to creating the wealth of this country and the United Kingdom. I am faced with a perverse argument in favour of reducing the size of the banking sector in Scotland, which would cause havoc to thousands of people around the country. I find that an absolutely unbelievable proposition to have been put to me this morning.

Ms Alexander: No, the unbelievable proposition is that the Government has published no work of any kind whatever on the impact of the bank bail-out on Scotland. The figures are not available from the Government. Why are we waiting for analysis from the Government of the size of the banking sector in Scotland and the capacity of an independent Scotland to underwrite those institutions, which have been so effectively underwritten by the Bank of England and the tripartite authorities?

John Swinney: We are now back to Wendy Alexander's problem with the size of the banking sector and her aspiration to reduce it. I find that a ludicrous proposition. I would have thought that the core of the committee's aspirations would have been to develop and strengthen the banking sector.

Ms Alexander: And underwrite it.

John Swinney: The argument is being advanced by Wendy Alexander—I cannot imagine that the view is shared across the committee—that we should be working to reduce the size of the banking sector in Scotland. I find that an absolutely unbelievable proposition.

The Convener: Let us move on.

Marilyn Livingstone: How has the Government changed and directed FiSAB's strategic thinking to take account of the financial crisis? How has the Scottish Government, through its chairing of FiSAB, sought to mitigate the impact of the financial crisis and, importantly, plan for the way forward?

John Swinney: As I said in answer to the convener's question about the strategy for the financial services industry in Scotland, FiSAB reviews that on an annual basis to ensure that all the interventions that we make are appropriate and beneficial and that they support the development of the financial services sector in Scotland. The strategy considers a number of different questions. It looks at Scotland as a location in which to do business; it considers the skills and capabilities of the population to provide an appropriate flow of personnel to work in the sector; and it assesses some of the competitive factors that will have an effect on the prospects of the industry. Those things are examined annually.

In addressing the challenges that we face just now, we have developed as part of FiSAB the financial sector jobs task force, which offers support when there is a threat to employment in the financial services sector. The committee has already heard from the task force. In addition, David Thorburn, the chief operating officer of the Clydesdale Bank, has been leading a process for FiSAB on the establishment of a skills gateway for the financial services industry in Scotland. That will ensure that the relationships between financial institutions and higher and further education institutions—and other education institutions—are aligned so that the correct approach is taken in terms of personnel.

All those issues are part of the routine analysis that FiSAB will undertake to ensure that the industry is well equipped to meet the challenges of the future.

Marilyn Livingstone: I do not know whether you heard the evidence that we took earlier from FiSAB. I take on board your points, but has FiSAB published an updated strategic plan since 2008? Is there anything tangible that the committee could see?

John Swinney: I would be staggered if the annual programme of FiSAB initiatives is not published and publicly available. If that is not the case, I will ensure that the committee is furnished with a copy. That is part of FiSAB's work programme. I will check that and, if there is a need to advise the committee, I will do so.

Marilyn Livingstone: That did not seem to be the evidence that we received this morning. Any information on updated plans would be most welcome.

David Wilson: The latest formal update of the strategy was in spring 2008. That was an update of the 2005 strategy that was referred to earlier. However, a series of updates is discussed at every meeting. That information could also be made available. There is also an annual report, which we can make available. Those are not formal updates of the strategy, but they are updates on work in progress. They show how things are being adapted, in recognition of the huge change in context.

Marilyn Livingstone: It would be helpful if we could get a copy of that information.

On a more general point, the Government has had to rethink support for the financial services industry following the crisis. I ask the cabinet secretary to tell us a bit more about that, particularly in relation to regional selective assistance and skills and education. What has the Scottish Government's focus been during the period?

John Swinney: On RSA, the approach is part of the work in which Scottish Enterprise and Scottish Development International will be actively involved to identify opportunities to attract investment into the Scottish marketplace. For example, the success in attracting Tesco Personal Finance and esure involved an element of RSA in the wider proposition of attracting companies to locate in Scotland. That approach will be revised, customised and structured around every single business proposition that Scottish Enterprise, Highlands and Islands Enterprise and Scottish Development International consider.

I mentioned previously two relevant points in relation to skills. One is that FiSAB considers the issues in relation to financial skills and financial services training and the links to the education institutions. That is part of the on-going work. Secondly, we have responded positively to a suggestion from David Thorburn of the Clydesdale Bank about the establishment of a financial services skills gateway. The gateway is designed to ensure that we have the best information and data on how individuals can be most appropriately supported to secure employment in the financial services sector. It also allows us to ensure that our institutions are educating and training individuals in a fashion that enables them to make a contribution to financial services employment.

Marilyn Livingstone: Across the board in our evidence sessions, we have heard that one important factor in financial services companies locating in Scotland is our highly skilled workforce and our pool of graduates and technicians. This morning, we heard from Mark Tennant that there is evidence in schools, colleges and elsewhere in the education sector that there has been reputational damage, which might affect people's choice of the financial services sector as a career—it might no longer be their first choice. I would like the cabinet secretary's view on that.

12:45

We are also hearing that candidates who are sufficiently qualified are being turned away from universities and colleges. According to *The Herald* this morning, only one in seven of those who apply to university—although I accept that the issue applies not just to university education—is being accepted.

Given the reputational damage to our financial services sector on the one hand and the lack of training places on the other, I think that we have a real crisis. If what pulls financial services companies into Scotland is our highly skilled workforce, how does the Government plan to ensure that our pool of talent does not diminish?

John Swinney: On the first point, the issue of reputation has been regularly discussed by FiSAB because we clearly need to be incredibly careful—indeed, “careful” is absolutely the word that I would use—about that. I think that there is a real danger of people going around trashing the country’s reputation in financial services, which has been built up over 300 years, because we have had two difficult years. We need to be really careful about that. There is a duty on public figures, members of Parliament, Government ministers and the industry to avoid falling into that trap, which would be really dangerous for Scotland.

In the past two years, many financial institutions in different countries around the world got into very severe financial difficulties. More than 100 institutions in the United States got into financial difficulties, but I do not see the United States going around beating itself up about the failure of some of its financial institutions. Therefore, I do not see why we should go around beating ourselves up about that. There is a real danger of our talking ourselves into a reputational problem that we do not need to have. There are still many attractive and positive reasons why people would want to be employed in Scotland’s financial services industry. I was previously employed in financial services, which was a very attractive career to me and remains an attractive career to many in Scotland. The Government would certainly support that outlook and perspective.

There is clearly an increase in demand for university places, but there are increasing numbers of places in higher and further education institutions. In the budget proposals that I announced last week, we put in place measures to support more places in our colleges. I caution that, just as we need to be a little bit careful on the issue of reputation, we also need to take some care with the numbers of university entrants. I know that the figures in *The Herald* yesterday have been the cause of some debate, on which I will write to the committee. I do not have all the detail with me today, but I understand that the Cabinet Secretary for Education and Lifelong Learning has some concerns about the data that were portrayed in *The Herald* yesterday.

Marilyn Livingstone: No member of this committee would want to damage the reputation of the financial services sector in Scotland. The effect of any reputational damage on people coming out of schools, colleges and universities is an issue that was raised by Mark Tennant rather than by a committee member. Do you think that that is an issue? If so, what can we do to reassure people? The point that I am making is that we want people to be trained in financial services. We do not want reputational damage; we want people to come into the financial services sector because they are why financial services firms say that they locate in Scotland.

Does your future planning include additional funding for the Scottish funding council to ensure that we can attract university graduates and technicians into the financial services sector? I think that I am asking you the opposite question from the one that you answered. How can we enhance the sector’s reputation in the school and education sector to ensure that we do not see a diminished pool or workforce? How do we ensure that we keep what we have?

John Swinney: We do that through the active promotion of financial services as an attractive career. That is undertaken through the work that Skills Development Scotland does with the education community to raise awareness of opportunities. It is also done through the educational programmes that form part of initiatives such as financial services week. I have seen some excellent presentations by school pupils on the importance of financial services skills and the attractiveness of employment opportunities. That work is also done through the wider promotion of financial services as an attractive career and an attractive industry in Scotland.

Ministers and the industry pursue and focus on that work in a number of ways. In that respect, we work closely with FiSAB and Scottish Financial Enterprise to maintain a wide awareness of the strength of the financial services sector and the importance of careers in it. I assure Marilyn Livingstone that we are actively involved in promoting awareness of financial services as an attractive career. Practical steps such as the skills gateway and educational programmes are designed to support that objective.

The Convener: On the written information that you will give us on university and college places, we are particularly interested in the factors that have a direct impact on the financial services sector, and not necessarily about the generality—at least to the extent that you can provide such specific information.

John Swinney: The information that I will provide should specifically address the issues around *The Herald*’s coverage. I know that there are some issues with that coverage, and I have not cited them all. If the committee will allow me, I will supply that information.

Gavin Brown: I return to some important issues around the Office of Fair Trading, which you said has a significant role to play.

You also said that informal discussions had taken place with the Office of Fair Trading. I am keen to find out what that actually means. How many meetings has the Scottish Government had with the OFT on banking since October 2008?

John Swinney: Certainly, there have been no ministerial meetings.

David Wilson: I regard that as part of the role that we and representatives of the OFT—particularly its representative in Scotland—have; that is what we expect to do. We have had a number of discussions on wider issues around competition, which have always covered banking but which were not specifically or only on banking. I could check back and get you the precise number of discussions, but I would have to give you the details later.

The OFT considers that the monitoring of markets is a key part of its statutory duties. It has not announced a formal review and it is not undertaking any formal consideration of competition in the banking market at present, but it clearly indicated at the time of the Lloyds-HBOS merger that it would almost certainly come back to the matter at some point in the future.

Gavin Brown: To be clear, are you saying that the OFT said that it would return to the subject?

David Wilson: It undertook a report, which was published on the OFT's website, as part of its consideration of the proposals for the HBOS-Lloyds merger, with a detailed analysis of the merger's likely effect on competition. That included a reference to reconsidering the matter in the future.

Gavin Brown: This is interesting. I have read the report, and we have had evidence from the OFT. Three issues were raised. One was competition relating to mortgages at a UK level; the second was competition in relation to personal and current accounts at a UK level; and the third was competition in relation to lending to SMEs at a Scottish level—that last issue was highlighted as being a purely Scottish one.

When OFT representatives gave evidence, we asked them what work had been done on the matter since October 2008. In effect, the answer was that not very much had been done. Their position was that, when the then Secretary of State for Business, Enterprise and Regulatory Reform, Lord Mandelson, decided—for understandable reasons—to override the OFT's concerns, he said that the matter should be kept under review. Are you saying that the OFT has told you that it will keep the situation under review?

David Wilson: I am not saying anything different from what the OFT or the secretary of state has said. The statutory organisation that is charged with the oversight of competition in the banking sector keeps the issue under review as a matter of course.

Gavin Brown: My concern is that, although the SME issue was flagged up as a particularly Scottish one and the secretary of state said that it should be kept under review, it was apparent to everybody who was here when the OFT gave evidence to us that it is not being kept under review in any formal sense. Given that the issue was flagged up as a Scottish one, why has the cabinet secretary not nipped at the OFT's heels to ensure that it is kept under review?

John Swinney: I have nipped at heels on the question, which is why the access to finance survey has been undertaken twice—in March and November last year. As I said, that information has been made available to the Treasury, which has a significant operational role in relation to the banking sector.

There is a choice in all such matters. We could try to influence the agenda and the choices in banking institutions; we could go down the route of a formal inquiry; or we could do both. The choice that I opted for was to marshal the information from the SME sector—Mr Brown is right to suggest that the position is apparent—and to make that available to the UK Government in a fashion that can influence the choices that financial institutions make. That is an orderly, operational way of ensuring that we influence the agenda.

Gavin Brown: You say that you are nipping at heels but, if I heard you correctly, you did not say that you have met the OFT to discuss the matter.

John Swinney: I said that I have nipped at the heels of the UK Government, which is the principal shareholder in the institutions. I have provided the information to it. As I said, I had a helpful discussion with the Chief Secretary to the Treasury just a couple of weeks ago, along with my counterparts in the other devolved Administrations, about how we can put together the material that will persuade institutions that issues remain with lending practice in Scotland.

Gavin Brown: I will make a request. I ask the cabinet secretary to review our evidence session with the OFT and to request formally that the OFT review the matter.

John Swinney: I will certainly review the OFT evidence session. We have made strenuous efforts through commissioning the survey to guarantee that we have the substantial data that would allow us to make the case for an improvement in practice. We must have those data at our disposal to have as significant an impact on the debate as we would like to have. The Scottish Government has assembled those data, which have been available to the UK

Government. I will certainly consider the OFT issue. If avenues remain for us to pursue, I will of course consider them. However, I point out that the Government has undertaken the analysis comprehensively twice.

Gavin Brown: I accept that, but I do not understand why the cabinet secretary is reluctant to commit to making a formal request to the OFT.

John Swinney: I have said that I will review the OFT evidence and consider the point.

The Convener: When the OFT gave evidence on 4 November 2009, Clive Maxwell said:

"we are examining cross-market issues, and considering different elements such as personal current accounts."

However, he went on to say:

"The OFT is not carrying out a new inquiry into small business banking in Scotland".—[*Official Report*, *Economy, Energy and Tourism Committee*, 4 November 2009; c 2601.]

It is fairly clear that, although the OFT is looking at some aspects of competition, it is not looking at that particular aspect, which was highlighted in the 2008 report.

13:00

John Swinney: I have chosen the route to pursue this issue that I have in order to reach a solution that will improve performance as swiftly as possible. With the greatest of respect to the OFT, I think that talking to the shareholders of the banking institutions is likely to produce a quicker outcome than an OFT inquiry. However, I do not want to disparage the OFT, or its timescales, in any way. That is the choice that I have made, but if the committee wishes me to look at that, I will certainly consider it.

Dr Gary Gillespie (Scottish Government Strategy and Ministerial Support Directorate): I can provide a bit of context that is based on the two surveys that we undertook. The first survey showed that the SME market in Scotland had been concentrated before the financial crisis. The Lloyds TSB takeover of HBOS added 6 or 7 per cent to the overall concentration, but the market has been highly concentrated for a period of time. Through the surveys, we have been trying to gauge whether there is any evidence of differential lending in Scotland as a result of that concentration. From the surveys to date, there is no apparent evidence of that.

The Convener: I recognise the point that you make. I highlighted earlier the issue of concentration prior to the Lloyds TSB takeover.

I want to ask about the effect that competition might have on the Scottish market for SMEs as well as personal current accounts. Did the Government make any representations to the EU when it was considering state aid issues in relation to RBS and Lloyds TSB? It is fairly clear from the evidence that the European Commission gave us that competition in the Scottish market was not one of the considerations that it took into account when developing the divestments policy.

John Swinney: The process was not consultative; it was a dialogue between the Commission and the financial institutions to effect the requirements of the European Union. The Government has clearly been in contact with the European Commission on issues raised by the approach to divestment, and we will continue that dialogue.

Lewis Macdonald: I take the cabinet secretary back to the question of regulation. You said quite rightly that there is a debate under way on how and where financial services should be regulated. Clearly, you have recognised that the outcome of that debate is critical if we are to sustain and grow the financial services sector. How is the Scottish Government taking part in that debate?

John Swinney: We are involved in the debate in a number of ways. We discuss these issues with FiSAB. I have made representations on specific aspects of regulation to the European Commission, such as on the alternative investment fund managers directive. The convener got in touch with me about the solvency II directive following the appearance at the committee of the Association of British Insurers. I have said that we will continue to make representations. As appropriate, we can have input into the discussions that take place with the United Kingdom Government into the bargain. We are having discussions with the UK Government on the UK Financial Services Bill—we have had appropriate input into that.

Lewis Macdonald: It is clearly important to have input on individual directives, but are you engaged in a dialogue with the UK Government on the changes that you would like to see in the regulation of banks in the UK? If so, what points are you making?

John Swinney: As I said, we are involved in discussions with the UK Government on the Financial Services Bill. We are in a position to take forward dialogue with the UK Government on all those questions and we will continue to do so. What is important—and what will be our guiding principle—is to ensure that the approach to financial services regulation is in the best interests of Scotland and the Scottish industry. We will continue to assert that.

Lewis Macdonald: Indeed—I am interested in how you do that. A big debate has been rehearsed in front of us on how the shape of banks should be adjusted internationally in the light of recent experience. On the one hand, Professor John Kay, for example, made the case—it has been referred to several times—for a narrow banking structure. On the other hand, Mark Tennant told us this morning that that was not the right way to go. Mervyn King and the Treasury have also expressed their views. Does the Scottish Government have a view on the big issue of the shape of banks that we might hope for in the future?

John Swinney: I have covered the range of options in my discussions so far with the committee. I do not think that any of us would argue the advantage of having a limited set of financial institutions; part of the strength of the Scottish market has historically been the broad range of players that deploy a broad range of interventions according to their different attributes. That has been the case in the Scottish market over time, and the Government is anxious to maintain it.

In some respects, one could say that the Scottish market does not have enough of the narrow banks, as Professor Kay would express it, but equally we do not need all banks to be narrow banks, because that restricts the opportunity for commercial advantage and opportunity. It is important that we retain a broad range of different providers, which is a fundamental characteristic of the Scottish financial services sector.

Lewis Macdonald: You talked about how different countries—and the United States in particular—have responded to the impact of the crisis that we have come through. You will be familiar with President Obama's proposition that those banks that serve retail customers should not be in a position in which they can own hedge funds and use their customers' money for purposes other than their customers' benefit. Does that strike a chord with the Scottish Government? Would you echo that type of view in the on-going debate?

John Swinney: The key principle that we must apply is to ensure that we avoid a situation in which there is any jeopardy to people's resources and investments. That is subject, of course, to the caveat that if one invests in the stock market, one does so in the knowledge that the value of stocks can go down as well as up. However, notwithstanding that, people have expectations about the security and the reliability of financial institutions and their management of resources. That characteristic has been temporarily lost in some of the financial institutions that have got into difficulty.

In the Government's opinion, the appropriate balance must be reflected in the outlook of individual institutions. Regulation needs to strike the right balance between allowing firms enough freedom to generate wealth, and ensuring that firms' individual or collective actions do not inadvertently cause more harm than good. That is the principle that the Government would take into discussions on the matter.

Lewis Macdonald: I am sure that we agree on the principle, but the question is how that should be achieved, which I would like to explore a little further. Do you agree that the methods that are used to achieve that objective are most effectively applied on a cross-border basis, whether that is at a UK, EU or G20 level? Is that an appropriate approach to the question of regulatory reform, as opposed to an approach in which different reforms are going in different directions?

John Swinney: Obviously, we operate in a global financial services market—that is a fact of life. Nothing over the past two years has changed that, because we were in a global financial services market before the crash, we are in one now and we will be in one in the future—it is part of the furniture now. We must therefore have an appropriate regulatory regime for that. I have already said in that regard that we must avoid having any confusion or contradiction between the regulatory requirements of regulatory focus A and those of regulatory focus B, which can happen if we do not have absolute clarity. The regulatory dimension will clearly be much broader than the UK level; it will undoubtedly be at a European level, but it is much more likely to be at a wider level than that because of the financial strength and significance of non-EU players in the global marketplace. All of that would have to be reflected appropriately in the regulatory structure.

Lewis Macdonald: On the UK regulatory framework, we have had some discussion about the OFT, which deals with a slightly different area. However, on the regulation of financial services, have you personally engaged with any of the tripartite authorities? Clearly, you have met the ministers in the Treasury, but have you met the FSA or the Bank of England to discuss matters? Are your officials engaged with Treasury officials on the specific issue of regulation of financial services, as opposed to one or two of the other issues that have been touched on already?

John Swinney: Certainly, ministers have had discussions with different elements of the regulatory regime, as have officials, and such discussions will continue. Obviously, this is a developing issue, and an active debate is under way. For example, a UK Government could specify its regulatory regime in the current environment, only to find that it was contradicted or superseded by a European or G20 regime. It is therefore necessary to ensure that all elements of regulatory change remain consistent with the environment that we are likely to face.

Lewis Macdonald: And you are discussing that with the FSA and the Bank of England, as well as with UK ministers?

John Swinney: We maintain very close attention to that debate.

The Convener: As a final point on that, it was remarked to us during our visit to London yesterday that global banks operate around the world but come home to die. We do not necessarily argue that large banks operating on a global basis should have discrete operations in each of the countries in which they operate. However, perhaps they should be subject to the capitalisation and regulatory requirements of individual domestic regulators, so that we do not have the situation whereby, when something goes wrong with a bank's operations in America or wherever, it is the UK taxpayer who ends up picking up the bill, which is what happened during the financial crisis with RBS and HBOS in particular.

John Swinney: That is a point that is very material to how this debate is concluded, because the level of capitalisation and the approach to capitalisation are fundamental to all that we have experienced in the past two years. We could say that banks should be anchored in the domestic market, but we could then find that the regulatory regime that gets agreed at European or G20 level contradicts that. The key question is whether there is an effective and robust approach to the capitalisation of banks wherever they operate—that is the test that must be passed. Clearly, it was not passed for some institutions over the past two years, but it must be the requirement of the regulatory regime that is applied in the aftermath of these difficulties.

The Convener: I am conscious of the time constraints on you, cabinet secretary. With your agreement, perhaps we can ask you in writing about a couple of relatively minor areas that we have not dealt with.

John Swinney: Yes, of course.

The Convener: I thank Stuart McMillan in particular for agreeing that we can do that. Chris Harvie has a final, brief question.

13:15

Christopher Harvie: It was quite evident to us in our discussions in London yesterday that we are moving into a highly regulated financial sector from the market dominance of the previous 30 years. However, during discussions at the Bank of England, it struck me that we can advance a significant area of collateral in that regard, which is the North Sea part 2—carbon capture and renewable energy. One noticed that that particular area was quite significant in the discussion of finance for industry and so on. What initiatives are you taking in that area that will, for instance, finance at a micro level housing improvement or low-carbon housing, and, at a macro level, attract investment into huge capital-intensive projects such as carbon capture and storage, and tidal and marine renewables?

John Swinney: Some of those practical considerations are at the heart of the debate that the committee is having. There is always a danger that it remains an abstract debate about lending and regulation. However, the debate translates into whether we are able to undertake economic development in some key areas. Professor Harvie is right about our renewables opportunity in that we must ensure that the flow of investment capital is such that we can make the most of the opportunity. In all respects regarding the material that the committee is examining, the Government is interested in ensuring that we have sufficient sources of lending to maximise opportunities.

A virtuous circle of benefit can come out of that approach. For example, there is greater opportunity to recycle and regenerate the investment in renewables because of the recurring flow of revenue that comes from that activity. There are therefore very good opportunities there, and the Government's focus on the renewables sector is clearly very significant in assisting that process.

The Convener: I thank the cabinet secretary, David Wilson and Gary Gillespie for giving evidence this morning. We will have a final oral evidence session at our next meeting on 24 February, when we will have Willie Watt, the chief executive of Martin Currie Investment Management Ltd, which is one of our leading investment management businesses. After that, we will begin consideration of our draft report.

Meeting closed at 13:17.

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

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

The deadline for corrections to this edition is:

Friday 19 February 2010

PRICES AND SUBSCRIPTION RATES

OFFICIAL REPORT daily editions

Single copies: £5.00
Meetings of the Parliament annual subscriptions: £350.00

WRITTEN ANSWERS TO PARLIAMENTARY QUESTIONS weekly compilation

Single copies: £3.75
Annual subscriptions: £150.00

Published in Edinburgh by RR Donnelley and available from:

Blackwell's Bookshop

53 South Bridge
Edinburgh EH1 1YS
0131 622 8222

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

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

And through other good booksellers

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

Telephone orders and inquiries
0131 622 8283 or
0131 622 8258

Fax orders
0131 557 8149

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

Scottish Parliament

All documents are available on the Scottish Parliament website at:

www.scottish.parliament.co.uk

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

Public Information Service
The Scottish Parliament
Edinburgh EH99 1SP

Telephone: 0131 348 5000
Fòn: 0131 348 5395 (Gàidhlig)
Textphone users may contact us on **0800 092 7100**
We also welcome calls using the RNID Typetalk service.
Fax: 0131 348 5601
E-mail: sp.info@scottish.parliament.uk

We welcome written correspondence in any language.