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Official Report

ECONOMY, ENERGY AND TOURISM COMMITTEE

Wednesday 28 September 2011

Session 4

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ECONOMY, ENERGY AND TOURISM COMMITTEE
7th Meeting 2011, Session 4

CONVENER

Gavin Brown (Lothian) (Con)

DEPUTY CONVENER

*John Wilson (Central Scotland) (SNP)

COMMITTEE MEMBERS

*Chic Brodie (South Scotland) (SNP)
*Rhoda Grant (Highlands and Islands) (Lab)
*Patrick Harvie (Glasgow) (Green)
Angus MacDonald (Falkirk East) (SNP)
*Mike MacKenzie (Highlands and Islands) (SNP)
*Stuart McMillan (West Scotland) (SNP)
*Anne McTaggart (Glasgow) (Lab)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Jim Eadie (Edinburgh Southern) (SNP) (Committee Substitute)
Sam Woods (Independent Commission on Banking)

CLERK TO THE COMMITTEE

Stephen Imrie

LOCATION

Committee Room 5

Scottish Parliament

Economy, Energy and Tourism Committee

Wednesday 28 September 2011

[The Convener *opened the meeting in private at 09:35*]

10:02

Meeting continued in public.

Interests

The Deputy Convener (John Wilson): I welcome everyone who has come along this morning. The committee has been meeting in private since about 9.30 and we now formally move into public session. I remind everyone to switch off their mobile phones and other electronic devices, which interfere with the sound system.

Jim Eadie is here to substitute for Angus MacDonald, so I invite him to declare interests that are relevant to the work of the committee.

Jim Eadie (Edinburgh Southern) (SNP): I have no interests to declare other than those that I declared in my entry in the register of members' interests.

The Deputy Convener: Thank you.

Decision on Taking Business in Private

10:03

The Deputy Convener: Do members agree to take items 5 and 6 in private?

Members *indicated agreement.*

The Deputy Convener: Thank you.

Independent Commission on Banking

10:03

The Deputy Convener: I welcome Sam Woods, from the Independent Commission on Banking. I understand that this is the first time that someone from the commission has appeared before a parliamentary committee to give evidence, so this is a unique experience and we are honoured that you have come along to tackle some of the issues that the Economy, Energy and Tourism Committee of the Scottish Parliament has raised. I invite you to make brief introductory comments.

Sam Woods (Independent Commission on Banking): Thank you very much for having me here today. I do not propose to make a grand opening statement, but I will make a couple of comments of a process nature.

First, I apologise for our being unable to field a commissioner today, as we would have liked to have done. Our inability to do so was purely a function of the tight timing between publication of the commission's final report and this meeting—the deputy convener alluded to that.

Members of the committee might be aware that we had two of our most major public events in Edinburgh. Both were chaired by a commissioner—one by Bill Winters; the other by our chairman, John Vickers, who also had meetings with several people in Scotland, including the First Minister. I would not want it to be thought that their absence from the table today reflects any disrespect or lack of desire to come to Scotland; it is purely a matter of logistics.

I am—until Friday—the secretary to the Independent Commission on Banking. I was responsible for leading the team that did all the work for the commission. In effect, I was the senior full-time person on the project for its duration. I hope, therefore, that I will be able to give a good insight into the commission's thinking on areas of interest to the committee.

I put on record the commission's thanks for the thoughtful submission that the committee made, which certainly informed our thinking. Rereading it this week in preparation for this hearing, I was struck by the fact that, although there is not total agreement on every point, there is quite a high degree of overlap and commonality between the thoughts and suggestions in the committee's submission and the position that the commission has arrived at. That is how it looks to me, anyway—I do not know how it looks to you.

The Deputy Convener: Thank you very much. I am sure that members of our predecessor committee—some of whom are members of this committee—will appreciate those comments.

We now move to questions.

Rhoda Grant (Highlands and Islands) (Lab): I will ask about financial exclusion. The report does not make much mention of credit unions and their ability to reach out. There is concern that, at the moment, the banks restrict banking services to people whom they see as being less of a risk, and that certain products are not always easy for people to access or have a higher cost attached to them. Has the commission carried out any work on that?

Sam Woods: It is fair to observe that there is not a lot on that specific topic in our report. We focused on a bigger question that is relevant to that issue, however, which is how to make banking more stable across the United Kingdom. It is apparent to everyone that the biggest cost of financial crises is the contraction of bank credit that results from them. There is some evidence that that might disproportionately impact certain areas of the economy. Although I have not seen it myself, it seems quite likely that issues around financial exclusion are exacerbated by that phenomenon.

We hope that the recommendations that we have made will help with the issue at that level. That is, potentially, quite important, but it is fair to say that we did not go very deep into the specific detail around the issue, mostly because of the breadth of what we had to achieve.

Rhoda Grant: Would it be possible to change some of the regulation around organisations such as credit unions? Some of the evidence that we have heard suggested that it would be a good idea to use the Post Office bank as a universal, one-for-all banking service. Bank branches are closing all over the place at the moment—that has been a problem with branches in rural areas for some years. However, if people could fully access all their accounts through the Post Office, banking would be available more locally, and there would be spin-off benefits for the Post Office as well. If credit unions were able to use the Post Office, and perhaps had back-room administrative facilities within post offices, that would allow everyone to have access to a much broader range of services.

Sam Woods: On the regulation of credit unions, I honestly do not know the answer to your question. I would rather not give you a bad answer.

On the Post Office, we considered how well equipped it is to provide back-office functions not only to credit unions but to credit institutions of all kinds, including banks. We wanted to test whether there is some insuperable barrier that means that it cannot provide that service—it already offers it—

and we formed the impression that it is well equipped to provide it. Whether it does so perfectly for everyone who seeks the service from it is probably more questionable. We took evidence from a lot of small banks—possibly credit unions, although I do not want to state that categorically—about how effective they find the service and, generally, they told us that it works.

The Post Office plans a major investment in its network—I do not think that we included the figure in our report, but it is publicly available. I imagine that that will improve the service further.

I will make one more general point. In thinking about the ring fencing of banks, which is one of our central proposals, we examined the building society model closely. Some useful lessons could be learned from that model, and we tried to incorporate them into our design for ring-fenced banks.

Jim Eadie: I will stay with financial exclusion, which Rhoda Grant raised, and the role of credit unions in addressing that, although I will broaden my questions out slightly to include some other alternative business models.

My main concern is that, although many of the commission's findings on stability and competition within the financial services sector will be welcomed, an opportunity to consider alternative business models has been missed. Those models include not only credit unions but building societies, financial co-operatives, mutuals and savings trusts. In failing to consider them, we have missed the point that competition is about not only the number of players in the financial services sector, but the variety of different models that are available. Will you comment on that?

Sam Woods: I will make two comments. First, our remit was to make recommendations about the structural and related non-structural reforms to the banking sector to promote financial stability and competition. I do not argue that that necessarily excluded deep investigation of financial exclusion or of the business models of all types of credit institution—of course it could be read as such—but, in the end, we did not think that we should devote a huge amount of our resource to investigating those avenues. The important exception was the building society model, from which there were a number of lessons that were directly analogous to our proposals, and we have tried to incorporate them.

My second comment is more a personal perspective than a commission one, as I used to work on financial exclusion. The United Kingdom Government has, in the past, done some interesting things on community development, finance institutions and community investment tax credit. It did a number of things that were specifically targeted at encouraging the provision of finance by institutions other than banks, particularly institutions that specialise in providing finance to non-typical businesses or the socially excluded. I have slightly lost touch with the impact of those measures, but I recognise that the issue is extremely important. It is fair to say that I did a lot more on it in a previous role that was focused directly on that issue than the commission did.

Jim Eadie: One point that the Association of British Credit Unions, which gave evidence to the commission, has made is that the

"strong and effective new challenger"

for which the commission calls as part of the Lloyds divestiture is a missed opportunity. That is the point that I sought to make.

Given that the commission considered building societies, what further measures does it envisage to support them?

Sam Woods: We had a lot of representations from the building societies and the Building Societies Association. The main thrust of their concern was that we should not introduce proposals that somehow disadvantaged the building society model relative to banks, and that we should observe and learn from the various features of the model that in their view are valuable and could have wider relevance for our work.

Both those things have been done. I forget exactly what the Building Societies Association said about our work, but Nationwide has come out clearly in favour of it. It is clear that we have addressed those interests.

10:15

Patrick Harvie (Glasgow) (Green): Good morning. Like Jim Eadie, I will broaden the question of competition and ask what it really means for diversity in the sector. In the past few decades there has been a continual drift away from mutuality and local banking, and an agglomeration of control in the hands of a very small number of massive banks. Given that change, it was almost inevitable not only that those banks would come to be controlled by people who would strut the world stage, kidding themselves on that they had magic powers, but that when things went wrong, they would go really wrong.

I will quote the report of the good banking summit, "Good Banking: Why we need a bigger public debate on financial reform", which the New Economics Foundation and Compass pulled together. The section on competition states:

"Remoteness from local markets"

—the move away from local banking—

"increases risks. As financial institutions grow they move further and further from their customers, and the knowledge of the products they are buying, selling or trading inevitably suffers. The fact that the crisis was sparked by an international market in subprime mortgages in the United States, about which very few had any real knowledge or great understanding, underlines this point."

Why did the commission not take the opportunity to challenge fundamentally the idea that control of the sector must be in the hands of a small number of massive players, which is even more concentrated in Scotland than in the rest of the UK?

Sam Woods: We focused on that topic directly, so I will respond at greater length to that question. I note in passing that we have had a great deal of helpful and stimulating engagement with the New Economics Foundation.

We are doing two things that speak directly to that issue, one more importantly than the other. The first is our proposal for ring-fenced banks, which is motivated in part by some of the concerns that you express, such as whether we can envisage a return to banking that is more focused on the everyday banking needs of individuals and small and medium-sized enterprises, as well as larger businesses, here in the UK.

I believe that the proposal will deliver that effect to a fairly significant degree. To put it crudely, roughly £1 trillion of credit will have to be contained in ring-fenced banks, and will not be able to be used for global investment banking. That is a big change from the situation in the past. It goes directly to the heart of what you have said, and of the point that the committee made in its submission to the commission, which emphasised—I may paraphrase this slightly incorrectly—a return to more old-fashioned banking on Scottish principles. There is an element of that type of thinking in where we have come out.

The other relevant point is the argument about whether universal banks make the world a safer place. Some argue that, by becoming ever larger and ever more diversified, banks become safer, thereby making the whole financial system safer. I do not think that the evidence clearly supports those arguments, in two respects. First, if we take a crude view of what happened in the financial crisis, banks of all shapes and sizes failed, including some very large universal banks, so even at first glance the argument that universality and greater size, and diversification and agglomeration of the sort that you describe, make for safer banking is questionable.

Secondly, and more fundamentally, is the question whether banks all diversifying in a similar way and becoming bigger and bigger makes for a safer system. That may well make the system as a whole more likely to blow up in a big way.

Our ring-fencing proposal addresses that directly by introducing greater modularity and a firewall. In particular, to address one point that you have made, we aim to better insulate everyday banking services in the UK from explosions elsewhere in the world of the kind that occurred in the previous crisis. Not everyone might agree with us—I am absolutely sure that we have not gone as far as the New Economics Foundation would like us to have gone—but we got stuck into that important issue directly.

Patrick Harvie: Perhaps I misused the word "diversity". I was talking not about large banks diversifying their businesses internally but about diversity in the business ecology—about the range of small organisations that could exist.

The commission has not reflected the value that could be gained from our having the system that is in place in other European countries, where a much higher proportion of financial services industries is in the hands of small, local and regional banks, as well as mutuals, co-operatives and municipal banks. That is not to say that private banks do not have a role, but that role is contained in a healthier business environment, which delivers not just safety by reducing risk but a connection to the local communities that the industry is supposed to serve.

Sam Woods: It is perfectly fair to say that we have not deliberately promoted non-bank models—that is true. We did not think that we should do that. However, we have been mindful not to disadvantage any models, which could easily be an accidental by-product of the exercise in which we are engaged, and to learn from other models when they provide directly relevant lessons.

If you talk to some bankers, they will say that the commission's recommendations might well lead to the migration of some activity out of banks and into other institutions. People argue about whether that is a good thing; some of that might well be a good thing.

Stuart McMillan (West Scotland) (SNP): I am the only committee member present who was a member of the committee in the previous session that undertook the banking inquiry, so I thank you for your comments. I know that Gavin Brown, who is not here today and who was also a member of the previous session's committee, would echo that.

My point about competition follows on from Patrick Harvie's questions. I am a wee bit concerned about what might happen in the future. I know that ring fencing has been suggested, but I am concerned about the UK Government's political will to deal with banks that want to merge at the UK level. Our predecessor committee raised that issue during its banking inquiry—the example that we all used was Lloyds Banking Group. That involved the merger of four institutions over a long period, which cut competition on the high street and removed the opportunity for people to change from one institution to another. How can you guarantee that there will be the political will in the future to prevent such an operation and such a direction of travel from happening again?

Sam Woods: I agree with much of what you said. We said clearly in the interim report and the final report that the merger of Lloyds and HBOS was a mistake from competition and financial stability perspectives. However, given where we are now, we reached the view that unpicking the deal so that HBOS and Lloyds TSB could be recreated as they were would not be sensible on the basis of the benefits that that would deliver or the cost.

We hoped to address the competition issues in three main ways. Would it be good if I sketched those out and then returned to your question?

The Deputy Convener: Go ahead.

Sam Woods: In a nutshell, we said three things on competition: we looked at the structure of the market, behaviour and regulation.

First, on structure, we decided that the thing that we were most concerned about, and the area where there was the biggest opportunity, was the exit from the market of a number of challenger banks. We reached the view that very small banks, while helpful for the market, did not exert a big competitive constraint over large incumbent banks but that banks in the middle zone did have such an effect.

We were concerned about the potential change in the dynamic of the market with the exit of a lot of those players. We therefore considered that our primary objective should be to secure the emergence of a strong new challenger bank on the high street. We observed that the best way to achieve that would be through the Lloyds divestment, which is currently under way—best in the sense that it would be the most cost effective. We have some concerns about whether the divestment as currently structured will form such an effective challenger, and we have laid out some thoughts on that in our report, but as a point 1 we want to see a strong new challenger on the high street.

The recommendation is perhaps a bit crude, but personally I think that it is persuasive and, if we do not see such a bank, competition will be worse. In that context, we comment in particular on the concentration levels in Scotland. We do not comment in great length, but it is the only specific country or regional issue that we pick out. Concentration levels will be high even after the divestment, particularly in the SME market, so we include that issue in our report.

Stuart McMillan: Can I interrupt on that point?

Sam Woods: Yes, of course.

Stuart McMillan: Scotland is different from elsewhere in the UK, with the Royal Bank of Scotland and Lloyds Banking Group, and the Bank of Scotland before that. In our predecessor committee's inquiry in 2009, most people provided evidence that there needed to be more competition on the high street to help individuals and businesses. However, although nobody came to the committee to say this, anecdotal evidence that committee members received from individuals in our constituencies and regions was that the fact that we have two large institutions is very good, particularly for the business sector. The two of them compete strongly against each other, which drives down rates, particularly for the small business sector. No one was prepared to come and give that evidence to the committee and put it on record, but anecdotally it is what we were all told.

Sam Woods: That is interesting. To be honest, we did not hear that—although that is obviously not to say that it is not true.

All the available evidence on the relationship between concentration in retail banking markets and outcomes for consumers shows that, all other things being equal, more concentration tends to equal a less good deal for consumers—which is not surprising. That will obviously not be true in every case all the time, and it may not be true in Scotland, but we were concerned about the concentration levels. Before the impact of the RBS and Lloyds divestments, the SME Herfindahl-Hirschman index is more than 3,000 in Scotland, which is high. The divestments will bring it down a lot, but we were concerned about concentration.

Our first recommendation was therefore on structure; the other two were on behaviour and regulation. There are two points on behaviour. First, it is clear that switching rates are low, particularly in the personal and SME current account markets. The authorities have trawled over that issue extensively in the past. One major impediment is that people worry that, when they switch their bank account, the direct debits will not follow properly. They are right to worry about that because the system does not work sometimes, and the proportion of times it does not work is not trivial.

Our proposal, which has some expense for the industry—not huge, so there is an opportunity to secure it—is that a redirection service should be introduced so that, as with the post when someone moves house, the direct debits will naturally ping through for 13 months after the account moves. In some sense, that delays any problem, but I think that it will give greater confidence to people who are moving accounts and I think that it will make a difference. Some bodies argued that such a system would transform the market by itself. I do not believe that that is true, but I think that it is a good step forward.

The second aspect on behaviour is transparency. A good switching service is pointless if people cannot tell the difference between the products. Again, that area has been trawled over in the past, and we make some further suggestions about it.

10:30

Our third recommendation was on regulation. Our observation was that, although the problems that we looked at were exacerbated by the financial crisis, some of them had existed for a while in varying degrees.

We thought that there is a unique opportunity at the moment, with the splitting of the Financial Services Authority into two separate parts—the prudential regulation authority and the financial conduct authority—to elevate the role of competition in the financial sector regulator. We think that the competition regulator should continue to be focused on competition, and we have recommended that the financial conduct authority should have a top-line duty to promote competition. In principle, that has been accepted by the Government, but we have suggested that the Government's current wording on the matter is not strong enough and should be beefed up. Those three things will, together, make quite a difference.

On Stuart McMillan's specific question, I cannot guarantee that the political will is going to be there—it would be a bit foolish to do so. However, I think that the experience of the crisis and the way in which the market is now structured will give people real pause when they are considering whether to allow bank mergers, at least in the foreseeable future.

Stuart McMillan: Forgive me. I acknowledge that my question was a wee bit facetious. However, the timeframe for the recommendations in the report runs to 2019, which will take us beyond the next United Kingdom general election. We do not know how the economic climate will look next week, never mind in 2017, 2018 and 2019. I suggest that the proposed lead time is potentially too long to enable the majority of the recommendations to be fully implemented.

Anything can happen in politics. We will have another UK election at some point. Also, who knows what will happen to the constitutional arrangements? I will not say that the whole report was not really worth doing, because it is certainly useful and will make the banking sector in the UK a lot better than it has been. However, with such a long lead time there is a large question mark over the report's effectiveness.

Sam Woods: We gave a lot of thought to that matter. The main point that I want to make is that there is a distinction between the political economy point, which is about how quickly one can get recommendations agreed to, and the question of how long, after the recommendations have been agreed to, is allowed for implementation. The two things are different but they sometimes get merged in people's thinking.

On the political economy point, it is important to note that the commission did not think that it was its role to dictate terms to Parliament about when it should do what. That would be totally inappropriate. However, we said that we thought that the Government should respond by the end of this year, which is pretty soon. The Government is committed to doing that. The team is in place and I have already had handover meetings with colleagues at the Treasury who will take matters forward, so I think that the Government will meet its commitment. The Government has not yet made its position clear, which is perfectly proper, but the mood music has been strongly positive.

We said that any legislation should be introduced during the lifetime of the current Parliament—I think that John Vickers said that that should happen

"well within the current Parliament".

That is a reasonably long time, but we are talking about big changes and the type of legislation that will be needed is potentially complex, so it might be a mistake to rush it. Having said that, a debate is going on in the UK Parliament—which I do not think that we should be engaged in—about whether we should have a separate bill or tack some of the stuff on to a financial services bill that is currently going through the Parliament. We do not have a view on that.

We said that we wanted full implementation as soon as possible and—as a final backstop—by the beginning of 2019. Why 2019? The main costs of what we have recommended are private costs—that is, more capital and/or more expensive funding for banks, both of which we think are fully justified by the benefits. However, we were concerned about trying to introduce such changes on a rapid timescale. Given the state of the economy and what is going on in global markets, that did not seem like a sensible thing to do. It might also not be very practicable, because some of the ring-fencing stuff represents quite a big change.

That led us to think about how long is sensible. All the international capital agreements run to 1 January 2019. The question then was whether we should differ from that by a year or two, but that did not seem very sensible. That was the logic, but I cannot say that you are obviously wrong in what you say, Mr McMillan. In the commentary around our report quite a lot of people have offered the same view as you, so maybe our timescale is a mistake. However, I think that it is the right way to do it.

Stuart McMillan: We all hope that by 2019 not just the Scottish or UK economy but the world economy is in better shape. The proposals in the report are aimed at dealing with the current situation, and if the world economy is in better shape by 2019, the proposals may be out of date before they are fully implemented. I am concerned about that—I note that colleagues are nodding their heads in agreement with me. I do not see any future proofing of the proposals for what we hope will be a better economic situation by 2019 and beyond.

Sam Woods: That, in truth, I do not agree with. We have tried to produce proposals that will make the UK better able to withstand financial crises in the future. I think that they will certainly do that both in terms of probability and—more important—in terms of the impact of financial crises on the UK in the future. We have made no assumptions around what the specific nature of those financial crises will be. We have not tried to predict when they will be, but we have assumed that there will be more financial crises. Our reforms are intended for the long term. They are not intended for tomorrow. We have not designed them to fix the most recent crisis—that would be a mistake. We have tried to learn from that crisis, and then put in place a package of measures that will work for the long term.

To be a bit more specific—people can argue about whether this is the right way to go—we thought that going a moderate distance on a number of measures, such as making some structural reforms and having more loss absorbency, was a better approach than going all the way on any one measure. People say to us, for example, that the right answer is to have tons more equity and everything else is a total waste of time; that the right answer is bailing out and everything else is a total waste of time; or that the right answer is a total split of the banks and everything else is a total waste of time.

In the end, we thought that aspects could be taken from all those ideas but that it was likely to prove more robust and more effective to combine them in more moderate form. That was partly because, to echo your point, we cannot be sure what the next crisis will look like. Now, that may be wrong-headed and a typical British compromise, but that was not the mindset in which it was done.

Patrick Harvie: My question follows on from Stuart McMillan's questions on timescale. The banking and financial services industry has one of the best-resourced lobbying machines in the world. What needs to be done to clip its wings in the meantime to ensure that even these modest reforms are not watered down to the point where they cannot be recognised for what they were?

Sam Woods: That is a tricky one. I would not characterise our proposals as modest, by the way, in aggregate—I do not think that they are; I think that they are quite big changes.

Patrick Harvie: I did not expect you to regard them as modest, but I do.

Sam Woods: Fair enough. I realise that some people take that view, but some people take the opposite view. What would I say about bank lobbying? Well, we of course had to engage widely with a huge range of stakeholders in the course of our process, which yielded a lot of benefits for us. Obviously, one group of stakeholders that we engaged with was the banks. To be fair, I think that the banks' quality of engagement with our project has been good. I do not think that they have been cynical. They provided us with the information that we asked for and worked effectively with us in a way that did not hinder our objectives. A number of them are perhaps not delighted with the result. Given my personal experience, I do not feel that bank lobbying has somehow been invidious for our process.

I recognise the risk that you describe, which is that, as the process moves into what I hope will be a more technical phase, the interest of some other parties will fall away. There is obviously a risk in that because, even if you are a very fair-minded politician or official, if you hear arguments from only one quarter, it is human nature that that is likely to sway your view. It is therefore important that other parties—I hope including the committee—continue to take a strong interest.

The Deputy Convener: Should the recommendations in the report be adopted in full? Do you fear either the Government or the banking industry trying to cherry pick some recommendations and discard the rest?

Sam Woods: The top line is that it is all or nothing; it is not a pick-and-mix package. We have constructed what we recommend deliberately so that the component parts work together. It is certainly the case that if one bit had fallen away or we had chosen not to recommend one bit, we would have recommended more in another area.

The commission's view is that cherry picking would be a mistake and would be ineffective.

There is one more layer, which is that financial regulation is an inherently complicated business. Our role was not to do very detailed rule making but to set out a framework—a blueprint, if you like—which had to be sufficiently detailed so that people knew what the recommendation was. It is a bit like peeling an onion. I guess that we are at the third layer and there are probably three more layers to go. It is obviously the case that, in taking forward the recommendations—as I hope the UK Government does—the Government will have to peel back the other layers and make some judgments on how to progress things. It is inevitable that judgments will require to be made, but that is different from cherry picking from the top-line stuff that we presented.

The Deputy Convener: I like your analogy about the layers of the onion. The reality is that the proposals will work only if their implementation brings tears to the eyes of some of the banks. The report makes some tough recommendations, which the banking industry must accept.

Chic Brodie (South Scotland) (SNP): I will ask a couple of questions on competition and then talk about risk and risk assessment.

I did not find any real comment in the report on ease of entry of banks to the banking system. Having talked to some recent new entrants to the system, I understand that there is some difficulty in getting clearing relationships with the big banks. Do you have any comments on that?

Sam Woods: Yes. In fact, we get stuck into that. In both the interim report and our final report, there is a section on barriers to entry—I forget the page number, but I can draw your attention to it later.

We were quite closely focused on that issue and, in the interim report, we floated three ideas on things that we thought might smell bad should we dig further and we sought further evidence on those. First, we were concerned whether there is a problem for smaller banks in getting access to the payment systems, particularly through large banks, that they need to operate.

Secondly, we asked whether we should promote the idea—possibly in a mandatory sense—of greater branch sharing, so that large banks with big networks would have to share their infrastructure with smaller banks. That is particularly important for things such as small and medium-sized enterprise banking, which involves a lot of cash handling. Establishing the infrastructure is a big overhead and the evidence clearly shows that branches are important.

Thirdly, we were concerned that there might be a regulatory barrier in terms of capital requirements for small banks being disproportionately higher than those for large banks.

We floated those three ideas and the one that we stuck with in some form in the final report was the third one. To be honest, I think that the evidence that we had did not give us a strong enough base to make a recommendation on the other two. It was not for want of trying, as we looked quite hard for the evidence. We talked to a number of people who the committee has also probably talked to.

The view that we got from the small banks, as a group, was that, although access to payment systems is an issue to keep an eye on, it is not a big problem. To us, the evidence did not seem to be there for strong intervention. It may be that we missed something, but we talked to the players and that was the view that we got.

10:45

We decided not to progress branch sharing for two reasons. We had a look at the interbank agency agreements, which also apply to the Post Office, and they seemed serviceable. Some banks told us that those agreements were used, but some small banks told us that they did not want to use other banks' branches, because they were worried that, if their customers went into them, they would see the other banks' offerings and would be poached. They did not like the loss of control. There was antipathy towards the idea from some—but not all—of the small banks.

On the capital requirements, we did not reach a categorical view that something was going wrong, but we were concerned that something did not smell quite right, so we suggested that the prudential regulation authority, together with the Office of Fair Trading, should take quite an in-depth look at the issue.

The other important point to make is that, in two ways, we have leaned against that. First, directly in line with a suggestion that was made in your predecessor committee's submission, we have taken the view that larger and more systemically important banks need to take some extra safety measures, and we now have capital requirements that cut the other way: large retail banks will have to have more capital than small banks. If that is accepted, it will be a new feature of the regime.

Secondly, we have gone very directly after the too-big-to-fail issue. A lot of market participants think that if our recommendations are implemented in full, they will provide an answer to their question. That is important from a competition point of view, because too big to fail means that systemically important banks that people think will be bailed out get funding at cheaper rates than small banks that will not be bailed out, which creates an obvious competitive advantage for those large banks. That seems like a very bad thing.

Chic Brodie: My next question is again on competition. The people who seem to be forgotten in all of this are the customers. Why is it so difficult for a customer to be able to transfer their account number and so on from one bank to another? What advice—the report is fairly lengthy and the answer may be in there somewhere—has been given to the banks about the restriction of trade as regards the use of ATMs, for example, and the charges that pertain thereto?

Sam Woods: We have done quite a lot of work on the first issue that you raised. We think that switching must be improved. It must be made easier for customers—not just individuals but SMEs, in particular—to do exactly what you describe. In truth, it will always be more complicated to move a bank current account than it will be to buy an apple—that is inherent in the system—but surely the process can be better than it is today.

The question that we asked ourselves was whether we should go all the way to account number portability—which is the phrase that people use to describe what you are referring to—as we have with mobile phones, or whether we should we try a redirection service that addresses the operational issue, which relates to direct debits, which, in our view, are at the heart of the switching problem. We thought that the redirection option should certainly be pursued, as there seemed to a strong case for it from the point of view of costs and benefits. We recommended that that be done, and I think that such a service will be taken forward.

However, we have not written off the idea of account number portability. We said that a redirection service should be set up and that, if it delivers significant benefits, that might prove to be sufficient, but if it does not, we should look again at account number portability. We should also do that if the costs of account number portability, which are quite high, prove to be lower in the future. That is perfectly possible, given how the technology is evolving. We have left things very much open.

Another comment that I would make on account number portability is that, as well as the cost, there is an unquantifiable risk, in that we are talking about the fundamental underpinning of our everyday banking system. We would want to be sure that we would get very big benefits from moving to account number portability in order to justify the risk of making such a change. That is not to say that we should not do it; I just think that the bar is quite high—it is certainly higher than it is for redirection.

Chic Brodie: We are talking about the ring fencing of retail banking and the firewall. The report says that its goals will

“contribute to financial stability internationally, especially in Europe.”

In the current situation, how are we securing financial security in Europe through the banking system? Given that we will ring fence retail banking as opposed to wholesale banking—and both sides will still sit under the constitution of one company—what happens to the retail side of a bank if the wholesale side of the business, with huge international assets, does down?

Sam Woods: On the first of those questions, we took the view, which is supported by the International Monetary Fund, that the UK’s financial stability is a major good, because we host a major financial centre and are a large economy. The simple act of putting UK banking on to a more secure footing should make a contribution to wider economic stability. Obviously, that is not going to happen in the immediate term, given the timeframe that we have suggested, but I believe that it will in the longer term.

We have directed our recommendations towards the UK, obviously. Some of the issues that motivate them are peculiar to the UK, such as the size of our banking system. However, we hope that there is something in this work that might be of interest to other countries as well. We noted that Michel Barnier—I think—of the European Commission said that he thought that it might be useful if other European countries undertook a similar exercise. I do not want to overclaim in that regard, but I think that there is some international interest and that people might be able to use our work to form their own views.

A third point, which also speaks to the wholesale side, is that there has been a greater focus in the coverage of our work on the ring-fencing elements, but we also attach a lot of significance to the loss-absorbing recommendations, and particularly to the idea that banks should have more capital and more primary loss-absorbing capacity, which would include bail-in debt—debt that is much more easily able to bear losses than debt proved to be in the last crisis, which is why the taxpayer had to take some of the hit. If adopted in the UK—or elsewhere—that would make a material contribution to potential stability, particularly for investment banks, which are typically funded to a great extent by wholesale debt.

On the question of what would happen to the retail side of a bank if the wholesale side got into trouble—we are talking about universal banks, as the question is not relevant for banks that do not have that double operation—at the moment, those activities are all commingled in a financial and legal sense. The example of RBS provides a good case history in that regard. There was no opportunity to deal with the situation differently, because the whole thing was one big jumble. The only options were to allow a big section of the country's basic financial infrastructure to shut down or to bail out the bank in its entirety, which was, in the end, an unpleasant but easy choice.

The point of ring fencing is to create more options. If you study the living wills that banks are working on, as we have done in some detail, you will see that, central to the idea of those is the idea that, in order to be able to deal safely—and without cost to the taxpayer—with a situation in which a big, universal bank blows up, we will need to be able to take it apart and deal with different parts in different ways. For example, on the wholesale side, we would not want a disorderly collapse of a trading book, but we might want to just wind it down slowly over time, whereas, for a retail bank, we would probably need to keep services being continuously provided while imposing losses on shareholders and creditors. Ring fencing, together with loss absorbency, would create the opportunity to do that. It would be possible to impose losses on the creditors of the bank and deal with the trading book in a certain way and the retail bank in another way. In the past, that option has not existed. A major motivation for our recommendations was to create that possibility.

Chic Brodie: You referred to banks' capital to assets ratio and the desire to increase capital. The ratio could be increased by reducing the assets, and therefore the associated risks. Does the report say anything about ensuring that any one major bank does not undertake a disproportionate balance of risk—for example, by investing too much in property as opposed to any other activity?

Sam Woods: We did not seek to make specific recommendations at that level, but we directly addressed that issue in the context of ring fencing. Crudely, our ring-fencing proposal is that retail deposits—which belong to all of us and to SMEs—must be within the ring-fenced bank and that, unlike the present situation, those funds cannot be used to support global investment banking. Some of the universal banks will tell you that they do not use deposits for that purpose. With regard to the internal management of funds, that may be the case but, as a matter of law, it is not. We are introducing a major restriction on what those particular funds can be used for.

However, we do not want to fuel the type of risks that you describe. If we were extremely restrictive in relation to what a ring-fenced bank could use funding for, we would, for instance, risk fuelling the next housing bubble. We think that it is very important to leave some flexibility in place, particularly to allow ring-fenced banks to lend to large non-financial corporates, because severing that relationship could have a real cost to the economy.

We also examined how risk weighting works. There is a chart in our report that shows what was happening with risk weights over time: they were dropping throughout a period when it was clear that the risk in the system was increasing. We think that a lot of progress has been made in that regard, but we recommend a leverage ratio so that if the risk weights are wrong—as they will always be to some degree—there is a backstop to prevent leverage from reaching the levels that it did during the previous crisis.

Chic Brodie: One can assume that the balance of risk is perhaps influenced by the remuneration at the higher levels of a bank.

In the executive summary, you state that

"it should not be the role of the state to run banks",

yet, on page 159, under the heading "Some arguments that market power can be bad for financial stability", you state:

> "Banks with market power are more likely to be ... 'too big to fail', and so have a proportionately greater implicit government guarantee."

That may not mean operationally running the bank but, given that we own 81 per cent of RBS, what role should the state apply to ensure that banks are run in the proper fashion?

Sam Woods: There is a distinction between the question of state ownership of banks and the issue of market power. In that context, we were using the term "market power" in a competition sense and simply observing that banks that have market power would typically be very large and that, without reform, there is a genuine too-big-to-fail problem. There is plenty of evidence to support that. We think that, far from being good for stability, it is bad for stability because it creates incentives to run excessive risks, as funding is in effect being provided on terms that do not reflect the real risk because the taxpayer is underwriting part of it.

One way to think about the question—this is not the commission's view—is that it is the state's role to run banks. In that view, which some people hold, banking is inevitably bound up with the business of the state, and we cannot get away from that, so the right thing to do is to have the state run banks.

The opposite view is that that is not the right way to run banks because of the risks that it creates, and that we want banks to be disciplined by the market within a sound regulatory framework. The commission has very much leaned in that direction. The worst of all possible worlds is the one that we have been in, where we pretend to be in the latter world but we are still on the hook and there is confusion. However, moving to the latter world is quite hard work, although the sorts of recommendation that we are making are trying to move us towards it. People argue for the state-run model; I do not buy it, but people do make the argument in perfectly cogent terms.

11:00

Chic Brodie: Thank you for being open and confirming that there is confusion. In any other trading situation, if a shareholder owned 81 per cent of an institution, I would expect them to have a much larger say in how it was operated. Why is that not happening, in the current confusion? I have already mentioned remuneration, although I do not want to dwell on it.

Sam Woods: Are you talking specifically about the Government ownership of RBS?

Chic Brodie: There is also a large shareholding in Lloyds.

Sam Woods: The last time I was before this committee, I was here for UK Financial Investments Ltd, which was a very different kind of job. I remember answering this question and, as I recall, not to the committee's satisfaction.

I would make two points. First, a real constraint arises because of the duties of the directors of the company—the members of the board. They have a duty to act in the interests of all shareholders. It is therefore not true that an 81 per cent shareholder can simply tell the bank to do X and that the directors will then simply comply with it even if they consider it not to be in the interests of other shareholders. That is a fairly fundamental part of company law.

The constraint is even greater in the odd situation of a state owning a company. In a private situation, the argument would probably be advanced by the private shareholder that something was in the commercial interests of the company, so the tension would not arise. The Government, on the other hand, might have a number of different objectives. The Government has to decide to observe that constraint for what it is worth.

Secondly, the situation should not be taken to mean that the Government does not take an interest in remuneration and governance at the banks in which it has a stake. Indeed, I lost a good couple of years of my life to that very topic. To give an example, the overhaul in the way in which people are paid at RBS has been one of the most radical around the world. I am sure that it is not enough to satisfy most people, but there has been a big change, and the shareholder was certainly involved.

Jim Eadie: Is the public interest sufficiently represented on the remuneration committees of the banks that we have been discussing?

Sam Woods: I honestly do not think that I can answer that properly.

Jim Eadie: You must have a view.

Sam Woods: But would that not require me to have a view on who is on those committees? In my previous job, I would have known, but at this point I do not.

The Deputy Convener: I respect that, Mr Woods. You are here to consider the report from the perspective of the Independent Commission on Banking.

Mike MacKenzie (Highlands and Islands) (SNP): Some cutting-edge economists now regard economies as biological ecosystems. I forget which one it was, but one evolutionary biologist said that it is not always the strongest or even the fittest that survive, but those that are able to adapt to change. Do you accept the analogy, and do you also believe that the present crisis is not just about the banks or about blaming the banks—after all, they were only doing what banks do, and we were all shocked but not surprised—but can be viewed as a failure of regulation? Much of the thinking in the report is not entirely new. Much of it comes from the Glass-Steagall act, so we have been here before, although perhaps not in our lifetimes. I have constituents who, in 2008, said that we needed to do essentially the same things that you recommend.

The timescale for reporting on the issues and the proposed timescale of 2019 remind me in evolutionary terms of the dinosaurs, not the species that survived change. I am worried by that failure to adapt and by the fact that you are concerned about the UK Government's ability to legislate within that timescale appropriately and robustly to maintain the ring fencing or firewall. Is the UK Parliament, with its various committees, structures and reporting conventions, a dinosaur? You can answer that question with a yes or no, if you like.

Sam Woods: I will answer at more length, if I may.

Mike MacKenzie: I would like a yes or no and then a bit more length.

Sam Woods: I will not a venture an opinion on whether the UK Parliament is a dinosaur, because that would be career limiting in the extreme.

Mike MacKenzie: I must apologise, because I did not realise that it would put you in that position.

Sam Woods: However, I will respond to the other points briefly. Convener, please say if I answer at too much length, because I am happy to be shorter if that is the case.

There is an interesting field of thinking on the ecosystems point. In particular, Andy Haldane at the Bank of England and Lord May of the University of Oxford are conducting work on what lessons we can learn from ecology and biology for the financial system, because the system dynamics may have some parallels—I judge from your question that you must be familiar with that work, Mr MacKenzie. We have examined some of that work and refer to some of it in the report. Particularly relevant is the idea that very large, diversified banks may be, in the jargon of disease control, super-spreaders—mechanisms through which contagion can spread through the system extremely rapidly—and that, therefore, extra inoculation may be needed for such organisations. I do not want to push that analogy too far, but it holds to a degree and it is reflected to a degree in our thinking, as well as international thinking on higher surcharges for such banks.

I totally agree with your point that it is not just banks. We were asked to examine the banks, which is what we did, but they are clearly only part of the picture. Everyone accepts that there were important failures of regulation. We did not get stuck into those not because we did not think that they were important, but because we were not asked to do that and because a lot of big change is already under way.

On timescale, I repeat that it is important that the UK Government should make its position clear quickly to give everyone who takes an interest some clarity on what is going to happen and to give certainty to the markets. It would be a very good idea for the UK Government to introduce legislation as soon as is practicable and certainly well within the current Parliament, which is what we have recommended. However, it would not be sensible to progress changes of such complexity and scale on a rapid timeframe.

That is my honest opinion, after I have worked on the matter for a year and a half and for a couple of years on the bail-out issues before that. It is big, complicated stuff. We are talking about moving around big bits of our economic machinery and it would be unwise to do that quickly.

Mike MacKenzie: My follow-on question concerns integrity—not only financial integrity, but integrity in its widest sense. The banks are sabre-rattling and saying we cannot make the changes too quickly. You say essentially the same thing. Given the fact that public and business trust in banks is at an all-time low and that trust is an economic factor, is it wise for you to give exactly the same message as the banks with regard to timescale?

Sam Woods: Optically, it was entirely obvious to us that that would be awkward and it did not serve the commission's interests at all to take the route that we have taken. However, we thought that the judgment was right. There was much public noise about that stuff in the run-up to publication of our report, but we formed our views before then.

Mike MacKenzie: I am concerned about what lies outwith the report. Does the commission have a duty of care—a moral obligation—to comment on factors that are outwith the scope of its remit but which are pertinent to the general problem that we are trying to deal with? Several issues that we would all agree are outwith your remit are nevertheless important. To what extent should you comment on those matters as a moral obligation? I am talking about managing risk not just at the macro level but at the micro level.

You talked about old-fashioned Scottish banking. I and many of my constituents want a return to the old-fashioned banking in which people shook hands with the manager who made the decision, he looked them in the eye and they looked him in the eye. Part of the problem is that, despite all the clever software and our number-crunching ability, the data that has gone into the system has not been of good quality. Machines and computers do some things very well, but there are other things that they do not do well and which humans do well. That is perhaps one aspect that lies outwith the commission's remit, but do you feel that you have a duty to comment on it? If so, what are your comments?

Sam Woods: I will respond to that point and then take the general point. Our hope—it is not totally implausible—is that the move to ring-fenced banks will lead to more customer-focused retail banking in the UK. That speaks to your point—perhaps not at the micro level, as you say, but at a higher level.

On the general point, the commission is decommissioned. None of the individuals who were involved is shy—one is a commentator in a major national newspaper. I would not be surprised if they offered views on all sorts of things, now that they are released from the commission. For due process reasons and for practical reasons—we had a huge amount to cover—we thought that we had to stick to our terms of reference and we tried to do that tightly. However, we are now in a different situation, and the commission's members have been released from that stricture.

Anne McTaggart (Glasgow) (Lab): Global research by the IMF has shown that the co-operative bank and mutual financial model is inherently more stable than that of the public limited company banks, yet the commission does not recognise credit unions, co-ops and mutuals in its recommendations.

Sam Woods: I am not sure whether the evidence strongly supports the argument that you describe. Some people make that argument, but we were not convinced by it. However, we did not argue the opposite—that the plc model is somehow superior. I honestly do not think that the data supports either argument.

We thought that the building societies model had something—particularly in how the treasury function works—that could provide a useful analogy for retail banking in the UK. In that context, we looked carefully at why building societies had got into difficulties and whether that happened before or after they were demutualised. From studying that, we gained confidence that elements of that model could serve our purpose.

Patrick Harvie: I will follow on from some of the areas that Mike MacKenzie touched on. There is little in the report on the ethos and culture of banking. For example, very few banks have ethical investment policies. Many of them pursue practices that are abundantly contrary to the common good. Perhaps the most significant is the facilitation of tax avoidance—one of the mechanisms that have ensured that the benefits of economic growth are captured by people who are already wealthy and that the gap between rich and poor grows so wide.

Those issues in banking practices speak to something fundamental in what is happening in our wider society, yet there seems to be nothing in the report about ethical issues and the culture of banking. Breathtakingly, I could not even find anything on remuneration—perhaps the single biggest iconic issue and one reason why the public has lost trust in banking. Did ethics come up in the commission's discussions? Why was it decided not to address those issues head-on in the report?

11:15

Sam Woods: Your observation is fair in relation to ethos and culture. There is a reason for our approach, but your assessment that those were not a big part of the report is true. We talk about remuneration a bit—

Patrick Harvie: There is no recommendation on it, is there?

Sam Woods: We do not make a recommendation on remuneration. Perhaps I can touch on that issue first and then come back to the wider question.

I suppose that there are two aspects to remuneration. First, is the way in which bankers are paid a problem? Secondly, are they paid too much? Those two points are distinct. On the first question, we had a look at the reforms that the Financial Standards Authority introduced—deferral, clawback and so on—and we took the view that we did not have much to add. Big changes had been made, they seemed perfectly sensible, and it was not an issue in relation to which our effort would get the highest return.

The level of remuneration is probably what motivates a lot of public concern. I may be wrong, but I think that at the root of the public concern—and what we tried to go after very directly—is the idea that the taxpayer is providing a subsidy for very big investment banking activities that is somehow flowing through to extremely high pay for investment bankers.

Patrick Harvie: I am not talking about publicly owned banks only.

Sam Woods: No, for all banks. The subsidy is not an issue that attaches particularly to publicly owned banks, as there is a state guarantee for banks across the piece. People find that issue invidious and unfair as well as dangerous, and we focused on it in the sense that it is an objective of the commission to remove the Government guarantee from banks.

To be crude, we could characterise it by asking: do we want to be tough on bonuses or tough on the causes of bonuses? In a separate role, I worked on bonuses, and I remember that people always said that the issue is all about the underlying structures and incentives. The commission has gone after that aspect directly. Anyone who thinks that the cost of the commission's proposals, if implemented, will not be borne in part by the employees of banks is kidding themselves. We therefore went into remuneration, but I recognise that we did not do so as directly as some people, including Patrick Harvie, would have liked.

On the more general point, the commission talked a lot about culture. I will make two points about that. First, we formed a view that culture cannot be sensibly regulated in a real sense. That may not be wholly correct, but that was the view that we took and we struggled to see what we could sensibly recommend in that regard.

Secondly, however, we focused on the fact that it is obvious that the retail banking side has a different culture from the wholesale investment banking side. It is not completely obvious that the unstructured commingling of those two sides is a good idea. Indeed, a number of people suggested that it is a bad idea. It may well be—this would be a good outcome—that the greater separation of those two types of banking through ring fencing will lead to more distinct cultures and the preservation of the right kind of culture on the retail side.

Patrick Harvie: I suggest that some ethical issues can be clearly regulated. For example, the Co-operative Bank ballots its members—its customers—on the components of its ethical policy. All banks could be required to do that—to introduce a degree of democratic control by the people whose interest they are supposed to serve.

Sam Woods: I understand that. We also made a recommendation in relation to the financial conduct authority. I fear that, again, that may not satisfy, but we took the view that it was the best way to ensure that customers are properly served, which is what we were most concerned about, particularly when things go horribly wrong for everyday customers.

Although payment protection insurance was not the only concern, we talk about it in the report, and it is a good, current example of something that has gone wrong. The view we took was that, within our remit, the best thing we could do to tackle that was to make sure that competition is more to the forefront of financial regulation. In the end, effective competition will deliver better results. I recognise that that is not a complete answer to the question.

Stuart McMillan: I have a point of clarification on the 2019 timescale. No one is suggesting that we are expecting changes within the next year or two but people are suggesting that the 2019 timescale is too long. We know that it will not happen overnight, but 2019 is far too far away.

Sam Woods: I understand that, but I do not think that you can prove the point either way. In response to Mr MacKenzie's point, I said that we did not do it that way because the banks wanted to do it that way. If anything, the optical result would tilt us towards going the other way. Having had a fair-minded look at it, we thought that that was the most sensible thing to do, given the scale of the change and where the economy is.

Mike MacKenzie: Given that this is the only look at banking regulation on the table, how much did you look at regulation of banks' microactivity in order to ensure—as Patrick Harvie mentioned—that banks have more ethical relationships, in terms of not just their investments but their customers? I am thinking of small businesses, whose overdrafts and finance agreements were essentially torn up. That was done just because the banks were able to tear them up, not because it was ethical or legally proper. How effective can the recommendations be, given the international scope of banks and the possibility of avoidance?

Sam Woods: On the first point, we were focused on how we could have more stable and more competitive—in other words, better—banking for SMEs, individuals and large corporates in the UK. That was the objective of our exercise, and our recommendations are designed to drive towards that in order to support better economic growth. It is true that we have tackled those at the macro level rather than the micro level. With the time we had and the area we had to cover, we thought it best to focus on big questions and not get into the detail of the conduct issues that the sector regulators would be better equipped to address. It may be that the creation of the financial conduct authority, which will be more exclusively focused on such issues than the FSA has been, will make a big difference. However, I am not an expert on that.

We thought about the international issue, which presents a constraint in terms of how far we can go. If the international community was going to go further than it is on equity requirements for banks, the commission might have thought that it, too, should go further. Some degree of a gap can be sustained for retail banking, but there was concern that an enormous gap would lead to international arbitrage. Some use that argument to say that we should not do anything and that all measures were impossible, but we rejected that view. However, it is a constraint that is baked in and any move to suggest watering down the proposal to accommodate that concern would, in the view of the commission, be a mistake.

The Deputy Convener: You referred to the Herfindahl-Hirschman index of the market for banking services in Scotland. The figure you quoted was "more than 3,000", which is very high and means that banking services are very concentrated in Scotland. Even with the divestment of Lloyds TSB and RBS, do you see that figure coming down to an acceptable level for banking services in Scotland? We are in Scotland and this is the Scottish Parliament, after all, and we need to ask ourselves whether the banking industry in Scotland will be opened up to a level that would be seen as acceptable elsewhere in the UK.

Sam Woods: I do not think that we reached that view. It is clear that the divestments will make a big difference, and I think that the concentration indices will come down a lot, certainly for SME banking and also for personal current accounts in Scotland. However, we did not reach the view that somehow it will all be fine; neither did we reach the opposite view.

The question for us in the report was the extent to which we should get into country-specific issues in the UK, and the one that we thought that we should mention was the one in Scotland, as it has been a big outlier for a long time. We thought that we should make clear our view of the facts, but we could not do justice to the issue within the scope of our exercise. Therefore, it would not be fair for people to read our report as saying that it will all be sorted once what you mentioned is done. We did not reach that view. That said, we were most focused on ensuring that there is a strong new challenger—that is particularly relevant for Scotland.

The Deputy Convener: Given that, as you have indicated, the report does not address the real issues relating to the index for Scotland, do you see further work having to be done either to regulate the banking system or to address the issues that have been identified for Scotland in particular?

Sam Woods: We had directly before us the question whether we should recommend to the Government that it should refer right away any of the markets to the competition authorities for investigation. The view that we formed was that there are currently many moving parts, not least the recommendations in the report, and that the sensible approach would be to wait and see the various results. Will there be a strong new challenger on the high street? Will there be much better switching, more transparency and pro-competitive regulation? If one or more of those things does not happen, there could well be a case for further investigation.

That said, nothing in our report precludes the possibility of the competition authorities conducting further work of their own in the meantime. We deliberately did not want to preclude that possibility. Indeed, I think that the OFT has to review the PCA market across the UK, which obviously includes Scotland, in the reasonably near future.

The Deputy Convener: I am aware that the previous committee and the Scottish Government both referred to the issue of banking services in Scotland, but I will move on.

On the transfer of bank accounts from one bank or financial institution to another, the current timetable for the introduction of the new fast-tracking process is 2013. Why could that process not be introduced sooner? Is there a particular issue?

Sam Woods: It is not absolutely obvious that that could not have been done in one year. It could have been possible, but quite a big information technology job is involved for the Payments Council and BACS, and the judgment that we formed was that it would be better to take a little bit longer. I think that the Payments Council took the view that it would like longer, and we thought that it would be better to take a little bit longer to ensure that people got things right. It would be the worst thing in the world to rush things through and have it all go horribly wrong. That would be a step backwards. We thought that that was a reasonable trade to make.

The Deputy Convener: We have the report and the recommendations, which the UK Government and other interested bodies will consider. On future proofing the banking industry, I return to a point that was made earlier. The report was the result of a banking crisis. The UK Government and the British people, including many Scots, had to step in to bail out financial institutions.

What confidence do you have that the action recommended in the report will prevent a future crisis in the banking industry in the UK, and further bailouts by the UK Government and, ultimately, the British taxpayer, so that the banks do not find themselves in the same kind of crisis again and then pass the problem on to the public?

11:30

Sam Woods: It would be foolish for anyone to state that this package of reforms, together with everything else that is going on, will mean that no bank is ever bailed out again; I do not think that this is an area in which you can have such categorical confidence. However, the commission's view—which I share, for what it is worth—is that the reforms will make a material difference to alleviating the probability and impact of future financial crises in the UK. If they do not, they are completely pointless and should not be carried out, but we certainly believe that they will.

The Deputy Convener: I thank Mr Woods for his evidence, which I hope will not hinder his future career after Friday.

Sam Woods: I hope not.

The Deputy Convener: The committee will consider the answers that we have received today and will produce a report in the next week—which will hopefully be sent on to the Scottish Government as well as the Chancellor of the Exchequer, George Osborne—setting out the issues that we have identified and the way in which we would like the commission's recommendations to be taken forward. Thank you very much indeed, Mr Woods.

We move into private session for the last two items on our agenda.

11:31

Meeting continued in private until 12:49.

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