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Scottish Affairs Committee

Banking in Scotland

Second Report of Session 2009–10

Report, together with formal minutes

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The Scottish Affairs Committee

The Scottish Affairs Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of the Scotland Office (including (i) relations with the Scottish Parliament and (ii) administration and expenditure of the offices of the Advocate General for Scotland (but excluding individual cases and advice given within government by the Advocate General)).

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The current staff of the Committee are Nerys Welfoot (Clerk), Alison Groves (Second Clerk), Ameet Chudasama (Committee Assistant), Becky Crew (Committee Assistant), Karen Watling (Committee Assistant) and Tes Stranger (Committee Support Assistant).

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Summary

This Report examines the impact on Scotland of the current economic crisis, specifically the recapitalisation of two of its largest banks: Royal Bank of Scotland (RBS) and the newly merged Lloyds TSB and Halifax Bank of Scotland. These banks have a special responsibility to fulfil the commitments made to HM Treasury to help their customers through these most difficult of times. However, we took evidence which suggests that customers are not being fairly treated by the very banks being supported by taxpayers' money to the tune of hundreds of billions of pounds. This echoed cases brought to us by constituents plagued by silent calls from call centres and other undesirable practices used by banks. We concluded that banks should continue to work with Citizens Advice Scotland to ensure that debt clients are treated with respect and care and helped to manage their finances responsibly.

We welcome the statements by RBS and Lloyds Banking Group that the majority of their employees were not involved in the risk taking business which lead to the downfall of RBS and HBOS and did not deserve the stress and anxiety that had been caused by the restructuring that had been brought in as a result. However, we are disappointed that both banks and the Minister consider it a necessary evil to reward certain bank executives with enormous bonuses when thousands of rank and file employees face redundancy. We are not convinced that there has been a change of culture within banks as a result of the crisis and we are concerned that front-line staff are still being pressured to sell potentially unsuitable products such as loans and credit cards to customers at pre-crisis levels.

Small and Medium Sized businesses are vital to the Scottish economy and have experienced extreme difficulties in the past eighteen months in accessing the finance necessary to keep themselves afloat. Whilst it might be inevitable, and perhaps desirable, that the same levels of easy credit are not available to businesses as they were before the banking crisis, we conclude that some SMEs are finding the increasing cost of finance a struggle. The UK and Scottish Governments should continue to work hard to ensure that Scottish businesses are given the necessary support to help them weather the current economic crisis.

We were gladdened to hear that Scotland's 300 year old reputation of excellence in the financial services sector does not appear to have been permanently damaged. Its skills base, lower costs and local infrastructure continue to make Scotland an attractive location for global companies to base their operations. We welcome the recent announcements by several financial services companies of job creations in Edinburgh and Glasgow as evidence of this continuing investment.

1 Introduction

1. In November 2008, following the capitalisation of Royal Bank of Scotland (RBS) and the soon to be merged Lloyds/Halifax Bank of Scotland (later to become Lloyds Banking Group), we agreed to take oral evidence on "the implications for Scotland of the current economic climate". On 10 December we took evidence from CBI Scotland, Professor David Bell, University of Stirling, Scottish Trades Union Congress (STUC) and the Scottish Chambers of Commerce. Following the continued Government assistance to RBS and Lloyds Banking Group, which both joined the Government's Asset Protection Scheme in February 2009, we took evidence in March from those banks and also Unite, STUC and Scottish Financial Enterprise. Specifically, the evidence sessions addressed the practical and competition implications of the merger between Lloyds TSB and HBOS, the operation of banks in Scotland following recent developments in the UK banking sector, and the provision of banking services to the public in the current economic climate.

2. In the light of the evidence received, the Committee decided to extend its inquiry and requested written evidence from interested parties on the following areas:

- The effect of the banking crisis on jobs, banking services to the public and small business lending in Scotland;
- The effect of the failure of Scottish banks and building societies on the international reputation of Scotland's banking sector, and
- The effectiveness of measures put in place by the UK Government to tackle the impact of the banking crisis and to aid recovery in Scotland.

3. We took oral evidence in November and December 2009 from the Federation of Small Businesses, Scotland, Law Society of Scotland, Clydesdale Bank and the Building Societies Association and further evidence from Unite, the STUC, RBS and Lloyds Banking Group. We also took evidence from Lord Myners, Financial Services Secretary to HM Treasury in January 2010.

4. At the same time as our inquiry, the Scottish Parliament Economy, Energy and Tourism Committee has held its own inquiry into "The way forward for Scotland's banking, building society and financial services sector."[1] Our Chairman met Mr Iain Smith MSP, Convenor of the Economy, Energy and Tourism Committee (EETC) on 29 September 2009 to discuss how best the two Committees could share evidence. We have found it useful to refer to the evidence submitted to the EETC. Similarly, the written evidence for our inquiry has also been published online and we hope that the Economy, Energy and Tourism Committee has found this to be of interest to its own inquiry.

5. We visited Ireland between 9–11 November in order to examine the operation of banks and provision of banking services to the public in a neighbouring country which had also suffered from the failure of its banks. We heard of the lessons learned and the steps Ireland

1 "Committee to assess effects of financial crisis on Scotland's economy and actions required to safeguard future", Economy, Energy and Tourism Committee press release, 11 September 2009

was taking to restore stability in its banking sector and repair the reputational damage done since the start of the global banking crisis in 2008. A full list of the meetings that we held and interlocutors that we met can be found in the Annex to this Report.

6. We heard that over-reliance on the construction sector and the subsequent collapse of the property market had pushed Ireland into recession by the middle of 2008. Most commentators had expected a soft landing for the inflated Irish housing market, but the international financial crisis had seen the “Celtic Tiger” collapse spectacularly on a scale that had surprised most. There was much public discussion about how to address the country’s financial problems, with no national consensus as to which cuts should be made. The public sector feared that pay cuts were to come whilst the private sector appeared to be resentful of the pay and conditions of the public sector.

7. The Government had been forced to safeguard all deposits with the major Irish banks and Building Societies, and subsequently took Anglo Irish Bank into public ownership in order to ensure its viability.[2] It was generally considered that the regulator had failed in the run up to the recession and in future would have to take a far more predictive role and stand up to the banks. Anglo Irish Bank had been heavily dependent on the property and construction sectors. The board responsible for Anglo’s collapse had been replaced and had not received large financial packages when they left. The Government had created the National Asset Management Agency (NAMA) as a so called “bad bank” to restore liquidity to the Irish banking sector, reduce uncertainty over bad debts and to stimulate lending to individuals and businesses again.[3] NAMA had purchased property and development loans of over £77 billion. There was general public discontent that the taxpayer had had to pay for the banks to the recapitalised and there was a concern that NAMA had paid the banks too much for their property portfolios.[4] However, we were told that NAMA had a commercial mandate to recover all debts.

8. We heard that the Irish Government had been forced to take drastic action to tackle the country’s deficit. The budget in December 2009 would be the first of a series of difficult budgets for the country as the Government tried to prevent further reputational damage to Ireland. As at December 2009, the Irish deficit stood at 12% of GDP, and the Government stated that it planned to reduced this to 2.9% by 2014. The Minister for Finance announced on 9 December, that his budget aimed to achieve €4 billion in spending cuts in 2010.[5] The Government announced that €1 billion would be saved on the public sector pay bill through pay cuts. From 1 January 2010, public servants would face cuts, from 5 per cent on the first €30,000 of salary, 7.5 per cent on the next €40,000, 10 per cent on the next €55,000 and 15 per cent on those earning more than €200,000. A cut of 20 per cent in the Taoiseach’s pay and 15 per cent in Ministers’ pay was also announced. As well as the public sector pay bill, €760m would be saved on the social welfare bill through cuts in child benefit and unemployment benefit, €980m would be saved on day to day spending programs and €960m on investment projects. In addition, a package of taxation measures had been

2 Statement of the Minister of Finance, Mr Brian Lenihan TD, 15 January 2009, www.finance.gov.ie

3 See the National Asset Management Agency website for more information, www.nama.ie

4 “Support for Nama has fallen since Dáil debate on issue”, *Irish Times*, 28 September 2009, www.irishtimes.com

5 Financial Statement of the Minister of Finance, Mr Brian Lenihan TD, 9 December 2009, www.budget.gov.ie

introduced. We were told that the challenge would be for Ireland to continue to attract foreign investment and to remain competitive.

9. We are grateful to all those who gave evidence to us or who took time to meet us during our visit.

2 Background

The banking crisis

10. It is not this Committee's remit to scrutinise the policy of HM Treasury or the regulatory authorities generally. However, 2008 and 2009 saw two of the biggest banks in Scotland, Royal Bank of Scotland and Halifax Bank of Scotland, and the largest building society, Dunfermline, get into severe difficulties which had a massive impact on Scotland's banking sector as a result. Since the run on Northern Rock in September 2007, the House of Commons Treasury Committee has published numerous reports on the international banking crisis, the subsequent failures of UK banks and the responsibilities of the regulatory authorities towards coping with the consequences of those failures. We do not intend to duplicate the work of the Treasury Committee, but will set out some of the background to the international economic crisis, including the Treasury Committee's findings, in order to examine the impact of the crisis on Scotland's banking and financial sectors and on the customers of those sectors. We have also previously reported on the circumstances leading to the failure of the Dunfermline Building Society and the transfer of most of its deposits and branches to Nationwide Building Society.[6]

11. In its seventh Report of 2008–09, the Treasury Committee identified several key factors as triggers of the financial crisis:

> First, the growth of risk and complexity, with a concomitant growth in profit, meant that too few people (including many of those in charge) had a clear idea of what was on the banks' books. Second, the banking sector became over-reliant on wholesale funding and discounted any possibility that the wholesale market would dry up; third, rapid growth in the sector was facilitated by increased leverage.[7]

The Treasury Committee also said:

> A culture of easy reward, illustrated by risky lending of credit and capital, has been underpinned by an assumption of continuous expansion in banking accompanied by and expectation of ever bigger bankers' rewards.[8]

12. The start of the banking crisis in the UK followed Northern Rock's collapse in September 2007, when the Government guaranteed all deposits and future deposits in Northern Rock and subsequently passed the Banking (Special Provisions) Act which took Northern Rock into a period of "temporary public ownership". On 21 April 2008, the Bank of England announced a £50 billion "Special Liquidity Scheme" (SLS) to allow credit-squeezed banks to temporarily swap illiquid financial assets like high quality mortgage-backed and other securities for highly liquid government bonds.[9]

6 Scottish Affairs Committee, Fifth Report of Session 2008–09, *Dunfermline Building Society*, HC 548

7 Treasury Committee, Seventh Report of Session 2008–09, *Banking Crisis: dealing with the failure of UK banks*, HC 416, para 10

8 Treasury Committee, *Banking Crisis: dealing with the failure of UK banks*, para 17

9 "Special Liquidity Scheme", Bank of England press release, 21 April 2008

The merger of Lloyds TSB and Halifax Bank of Scotland

13. On 17 September 2008 it was reported that Lloyds TSB and Halifax Bank of Scotland (HBOS) were to "merge"— effectively Lloyds were taking over an ailing HBOS — to form Lloyds Banking Group, becoming the fifth largest financial services provider in the UK.[10] In its memorandum, the Scotland Office states "HBOS had expanded at an inopportune moment in the financial markets and was particularly vulnerable to the freezing up of wholesale markets. It was clear by September 2008 that it would have been difficult for HBOS to continue as an independent financial institution".[11]

14. The Government amended competition law to allow the financial stability implications of the merger to be considered alongside the effect on competition. The Office of Fair Trading (OFT) assessed the potential effects of the merger on competition in Scotland. It found that there was a real prospect of the merger lessening competition in the areas of current accounts, banking services for SMEs and the market for mortgages. However, the OFT also concluded that HBOS could not continue independently without the Government providing a rescue package.[12] On the advice of the tripartite authorities (the Bank of England, HM Treasury and the Financial Services Authority) the then Secretary of State for Business, Enterprise and Regulatory Reform decided not to refer the merger to the Competition Commission on the basis that it would be beneficial to the stability of the UK financial system and in the public interest for the merger to go ahead.[13]

15. Lloyds has since said that it would not have required state aid if it had not taken over HBOS, whilst maintaining that the HBOS acquisition was a "prudent one".[14]

Recapitalisation package for UK banks

16. September 2008 also saw the division of Bradford & Bingley Bank after the FSA determined it was unable or likely to be unable to satisfy claims against it.[15] Then, on 8 October 2008, the Government announced a recapitalisation package, asking banks to increase their "Tier 1" capital ratios. The objective was to ensure that the banks had a level of capital "where people could absolutely clearly and without doubt have confidence in them" with "the net effect…that we have taken [the banks] to a level of capital which is well beyond what the classic international rules of capital adequacy defined."[16]

17. The package included a Credit Guarantee Scheme, which made available to participating institutions a government guarantee for inter-bank lending to refinance maturing debt. Participation required the payment of a fee to reward the taxpayer for the risk they were assuming; the fee was reduced in December 2008.[17] The package involved

10 "Lloyds TSB seals £12bn HBOS deal", *BBC News Online*, 17 September 2008, news.bbc.co.uk

11 Ev 153

12 Ev 153

13 Ev 154

14 Oral evidence taken before the Treasury Committee on 11 February 2009, HC 144, Qq 1922–1923 [Eric Daniels]

15 "Bradford & Bingley plc", Bank of England press release, 29 September 2008

16 Oral evidence taken before the Treasury Committee on 3 November 2008, HC 144, Q 9 [Lord Turner of Ecchinswell]

17 "Changes to Credit Guarantee Scheme", HM Treasury press release 138/08, 15 December 2008

injection of capital by offering to buy £25 billion worth of preference shares in the banks and making another £25 billion available for banks to increase their capital.[18] £250 billion worth of loan guarantees were made available at commercial rates and a total of £200 billion in loans was made available to banks from the Bank of England under the SLS.[19]

18. There were two options for participating banks: raising capital through the markets, or getting capital through the recapitalisation scheme. The two options came with differing conditions.[20] Only RBS, HBOS and Lloyds TSB used the recapitalisation fund; other UK banks raised capital privately.

19. On 13 October 2008, the Government announced that it would be injecting a total of £37 billion into Lloyds TSB/HBOS and RBS.[21] The result was 43% Government ownership of Lloyds Banking Group (as Lloyds TSB and HBOS became when they merged in January 2009) and 63% Government ownership of RBS.[22]

20. The receipt of public funds came with conditions. The banks agreed to:

- maintain over the next three years, the availability and active marketing of competitively priced lending to homeowners and small businesses at 2007 levels;
- support schemes to help people struggling with mortgage payments to stay in their homes and support the expansion of financial capability initiatives;
- address the remuneration of senior executives—both for 2008 (no bonuses should be paid to board members) and going forward (incentive schemes should reflect long term success and not reward failure);
- allow the Government to agree with boards the appointment of new independent non-executive directors; and
- restrict the payment of dividends.[23]

21. The Treasury Committee expressed support for the Government's recapitalisation package, saying that "it was clear that some UK banks would have collapsed without taxpayer support." However, it noted that the "unavoidable speed of implementation has meant that the implications for both banks and Government were [not] fully understood."[24] It also concluded that the Government should make it a priority to ensure that conditions regarding remuneration and lending levels were adhered to by the banks which have benefited from taxpayers' money.[25]

18 "Financial support to the banking industry", HM Treasury Press Notice 100/08, 8 October 2008

19 "Recapitalisation of the UK banking system", Bank of England press release, 8 October 2008

20 Oral evidence taken before the Treasury Committee on 3 November 2008, HC 144, Q 16 [Mr Alistair Darling MP]

21 "Treasury statement on financial support to the banking industry", HM Treasury Press Notice 105/08, 13 October 2008

22 HC Deb, 13 October 2008, col 543

23 "The banking support measures in detail", Directgov press notice, 13 October 2008

24 Treasury Committee, *Banking Crisis: dealing with the failure of UK banks*, para 146

25 Treasury Committee, *Banking Crisis: dealing with the failure of UK banks*, para 154

Asset Protection Scheme

22. In January 2009 the Government offered a more varied package addressing liquidity (by injecting money) and risk factors (by insuring debts). This included the Asset Protection Scheme (APS), the details of which the Government announced on 26 February 2009. The APS insured the banks against future losses on their riskiest assets and in return the banks had to pay a fee and enter into legally binding agreements, to increase the amount of lending they provided to homeowners and businesses, and to implement a remuneration policy consistent with the Financial Services Authority (FSA) recent code on remuneration policies.[26]

23. RBS and Lloyds Banking Group originally signed up for the APS. RBS were to pay a participation fee of £6.5 billion and bear a first loss of up to £19.5 billion for the insurance of £325 billion of assets.[27] Lloyds were to pay a fee of £15.6 billion and bear a first loss of up to £25 billion for the insurance of £260 billion of assets.[28] Both would continue to be liable for 10% of remaining losses. HM Treasury explained to the Treasury Committee on 17 March 2009 that RBS would be required to increase lending by £25 billion: £9 billion for mortgage lending and £16 billion for business lending. Lloyds would be required to increase lending by £14 billion: £3 billion for mortgages and £11 billion for business lending.[29]

The role of UK Financial Investments Ltd

24. On 8 November 2008, the Government announced that a new, arms-length (but fully Government-owned) company UK Financial Investments Ltd (UKFI) would manage the Government's shareholding in banks subscribing to the recapitalisation fund. The Chancellor's announcement said:

> UKFI will work to ensure management incentives for banks in which it has shareholdings are based on maximising long-term value and restricting the potential for rewarding failure. It will also oversee the conditions of the recapitalisation fund, including maintaining, over the next three years, the availability and active marketing of competitively-priced lending to home owners and small businesses at 2007 levels.[30]

25. Its overarching objective is to "protect and create value for the taxpayer as shareholder with due regard to the maintenance of financial stability and to act in a way that promotes competition."[31] One aspect of this role is to work with the banks as shareholder to ensure

26 "Asset Protection Scheme and increased lending", HM Treasury Press Notice 19/09, 26 February 2009.

27 "Asset Protection Scheme and increased lending", HM Treasury Press Notice 19/09, 26 February 2009.

28 "Asset Protection Scheme—agreement with Lloyds", HM Treasury Press Notice 23/09, 7 March 2009

29 Oral evidence taken before the Treasury Committee on 17 March 2009, HC 144-i, Q 2768 [Ms Mridul Hegde, Director of Financial Services]

30 "New company to manage Government's shareholding in banks", HM Treasury Press Notice 114/08, 3 November 2008

31 Information taken from the UKFI website, www.ukfi.gov.uk/about-us

that they offer incentives based on the Government's remuneration principles.[32] We look at the issue of remuneration and bonuses in Part Three.

Further funding for RBS and Lloyds Banking Group

26. On 3 November 2009, the Chancellor announced a further taxpayer contribution to the banks of over £30 billion, accompanied by some changes to the conditions on the banks.[33]

27. For RBS this meant that the Government would provide an additional £25.5 billion in new capital, with a further £8 billion contingent capital commitment (paid if the bank's core tier 1 capital ratio falls to 5%). As a result, the Government's economic interest in RBS rose to 84%, but the Government's ordinary shareholding will not exceed 75%. It was announced that Lloyds Banking Group would not participate in the APS and would instead raise additional private sector capital of £21 billion and pay a fee to the taxpayer for the implicit protection provided to date. The Government would use its existing 43% stake in Lloyds Banking Group to subscribe to another £5.7 billion worth of shares. In its announcement, HM Treasury stated: "This option represents better value for money for taxpayers, as the private sector will now provide the majority of the capital required to protect Lloyds from the downside risks to its balance sheet." HM Treasury said that these new agreements "have given both banks implicit protection for their balance sheets, allowing them to begin the process of rebuilding and restructuring the healthier core of their businesses and to increase lending".[34]

28. There were additional conditions including a crackdown on bonuses for those earning more than £39,000 per annum and an agreement to a "Customer Charter" for lending to small and medium enterprises. Also, in return for this state aid, the European Union Competition Commission ruled that both Lloyds Banking Group and RBS must sell off parts of their businesses.[35]

"Secret loans" to RBS and Lloyds Banking Group

29. As revealed on 24 November 2009 at a Treasury Committee evidence session, in the autumn of 2008 the Bank of England provided emergency liquidity assistance as lender of last resort to the Royal Bank of Scotland and HBOS.[36] In a press release, HM Treasury (HMT) said that the assistance was confidential at the time "due to extreme global market conditions." HMT considered that the banking market had now stabilised enough for the Government to explain its actions.[37]

32 Ev 155

33 "Implementation of Financial Stability Measures for Lloyds Banking Group and Royal Bank of Scotland", HM Treasury Press Notice 99/09,3 November 2009

34 "Implementation of Financial Stability Measures for Lloyds Banking Group and Royal Bank of Scotland", HM Treasury Press Notice 99/09,3 November 2009

35 "Implementation of Financial Stability Measures for Lloyds Banking Group and Royal Bank of Scotland", HM Treasury Press Notice 99/09,3 November 2009

36 Oral evidence taken before the Treasury Committee on24 November 2009, HC 34, Q1–4 [Mr Mervyn King]

37 "Special assistance for HBOS and RBS—October 2008", HM Treasury press release, November 2009, www.hm-treasury.gov.uk

30. The Governor of the Bank of England told the Treasury Committee that £62 billion had been lent to the two banks in October 2008. Use of the emergency facilities peaked at £36.6bn for RBS, on 17 October 2008, and at £25.4bn for HBOS, on 13 December 2008. RBS repaid the cash by 16 December 2008, and HBOS by 16 January 2009. The two banks put up collateral worth more than £100bn in return for the loans, which included residential mortgages, personal and commercial loans and UK government debt with a total value in excess of £100bn. The fee for borrowing was 1.7 percentage points above the usual lending rate.[38] In a letter to the Chairman of the Treasury Committee, the Chancellor of the Exchequer stated that he judged that the risk to public resources of HMT providing the Bank of England with an indemnity was "low" given the collateral given to the Bank of England by HBOS and RBS.[39]

38 Letter from Mervyn King to the Treasury Committee, www.bankofengland.co.uk/publications

39 Letter from the Chancellor of the Exchequer to the Chairman of the Treasury Committee, www.hm-treasury.gov.uk/d/letter_chx_to_johnmcfall

3 The impact of the banking crisis on Scotland

Scotland's financial sector

31. Scotland's reputation as a centre of excellence in financial services dates back over 300 years. The financial services sector directly supports around 91,000 jobs and the same again in support services in Scotland (equal to one in every ten jobs in Scotland).[40] The banking sector itself accounts for around half of the total contribution of the financial services sector to the Scottish economy.[41] As well as banking, the financial services sector includes life assurance and pensions, investment management, and asset servicing. It also has insurance and corporate finance and broking services sectors, as well as professional advisors and business service companies that work with the industry.[42] Lord Myners, Financial Services Secretary to HM Treasury, pointed out to us that despite the crisis in the banking industry, Scotland continued to have a very strong financial services sector.[43]

32. On its website Scottish Financial Enterprise (the representative body for Scotland's financial services industry) states that in 2008 the industry accounted for £7bn (over 7%) of Scotland's GDP (measured as Gross Value Added). This included both Scottish companies that are leaders in international markets and international companies that are investing in bases in Scotland.[44] More than half of the world's top 20 financial organisations have established substantial operations in Scotland.[45] Edinburgh is the UK's most important financial centre outside London, and is ranked as the fourth largest financial centre in Europe, when measured in terms of equity assets.[46]

33. In evidence to the Scottish Parliament Economy, Energy and Tourism Committee, Scottish Enterprise noted that, for the second time in four years, Scotland had been named European Region of the Future by the Financial Times fDi (Foreign Direct Investment) magazine. Of the numerous categories by which the prospects for regions were judged, Scotland scored highest in economic performance, overall fDi promotion strategy, quality of life, transport links, IT & telecommunications and human resources.[47]

34. As well as RBS, with headquarters in Scotland, and Lloyds Banking Group (which includes Bank of Scotland, Lloyds TSB Scotland and Scottish Widows Bank) with its registered office in Edinburgh, Clydesdale Bank and Standard Life Bank (recently sold to Barclays) both have their headquarters in Scotland. Prior to the current financial crisis the RBS was one of the largest banks in the world, and HBOS was the UK's largest mortgage

40 Information taken from the Scottish Financial Enterprise website, www.sfe.org.uk/about-us/

41 Ev 152

42 www.sfe.org.uk/about-industry

43 Q 754

44 www.sfe.org.uk/about-industry

45 Ev 152

46 www.sfe.org.uk/about-industry

47 Scottish Enterprise evidence to the Economy, Energy and Tourism Committee, www.scottish.parliament.uk/s3/committees/eet/inquiries/banking

lender. Together those two banks had more than 35,000 employees in Scotland. Lloyds TSB, then the UK's fourth largest bank had just over 7,000 employees in Scotland, and after the merger with HBOS, the Lloyds Banking Group had over 20,000 staff in Scotland and became one of Scotland's largest employers.[48] Clydesdale Bank has 4,000 employees in Scotland.[49]

Impact of the crisis on the financial services workforce

35. As at 20 January, the unemployment figure for Scotland was 202,000. Scotland's unemployment rate stands at 7.4 per cent of the working population compared to the UK rate of 7.8 %.[50] As reported by the BBC, a report published by Ernst & Young's Item Club at the end of November 2009 said that it expected job cuts to continue in Scotland, with the unemployment rate to reach 8% in 2010. The report stated that: "The recession has exposed a number of areas where there are disturbing weakness, not least financial services, business services and the hotel and catering sectors, which have all significantly underperformed compared to the rest of the UK." In the year to June output in the financial service sector shrank by 8.4% compared with 0.8% in the wider UK.[51]

36. The impact on the banking sector of the financial services workforce has been severe as a result of the restructuring of banks. Throughout 2008 and 2009 there have been several announcements of job losses from both RBS and Lloyds Banking Group. Clydesdale Bank told us that it had reduced its workforce by 75 in Scotland.[52] The Building Societies Association added due to the decline in mortgage lending and the savings market, its members had been forced to reduce their staff count, although there were less reported job losses in Scotland than the rest of the UK.[53]

37. Unite reported that the restructuring within RBS and Lloyds in particular was increasing stress and anxiety among the financial services workforce who were already demoralised by the economic crisis. It also argued that the flow of announcements of job losses across the sector was causing considerable damage to the reputation of the sector and was doing little to instil confidence for Unite members or in rebuilding trust in consumers.[54] In its submission to the Committee in September 2009, the Scottish Trades Union Congress (STUC) stated:

> [it was] difficult to provide accurate figures for job losses/gains in Scotland's financial services sector over the past year. The drip feed of job losses in RBS and Lloyds Group has been at least partially offset by new investments. Trade unions initially estimated that job losses in the banking sector following the crisis could be between 10–30% and it is difficult at this stage to provide a more accurate figure.[55]

48 Ev 152

49 Ev 131

50 "Scotland's unemployment total rises", *The Scotsman*, 20 January 2010, business.scotsman.com

51 "Scottish economy headed for more pain", *BBC News Online*, 29 November 2009, news.bbc.co.uk

52 Q 602 [David Thorburn]

53 Q 602 [Adrian Coles]

54 Ev 140

55 Ev 136

By 2 December, when the unions next gave evidence to us, it was apparent that the contraction in employment feared had not materialised. However, Rob MacGregor, National Officer, Finance and Legal Sector, UNITE, said that there was still no definitive figure for job losses in Scotland:

> in terms of the total announcements of jobs that have actually gone in 2009 and those we are aware will go in 2010 from the announcements that a number of employers have made, we estimate that there will be a net reduction of around about 5,000 roles, primarily in the banking sector in Scotland. So some of those will have already gone, but also within that figure are announcements for job losses that will take place primarily in 2010.[56]

38. However, CBI pointed out in its evidence that in some areas of financial services, firms located within Scotland were increasing their levels of employment.[57] In evidence to the Scottish Parliament Economy, Energy and Tourism Committee, the Scottish Executive listed several financial services companies that had recruited in Scotland during 2009:

- BNP Paribas began recruiting 80 new posts, the second tranche of a planned recruitment of 370 jobs in Glasgow;
- Esure announced the creation of 500 new permanent jobs in Glasgow – the first 250 of which would be recruited over the next 18 months. Esure Chairman Peter Wood cited the local skills base, infrastructure and "can-do" ethic as playing an important part in the decision;
- Tesco Personal Finance announced that it was set to create 800 jobs in Glasgow with the opening of a new customer service centre. The availability of a high quality workforce was cited as a reason for the decision to come to Scotland. This was in addition to its decision to create 200 new jobs and move its present 250 staff to a new HQ facility in Edinburgh.[58]

RBS and Lloyds Banking Group losses

39. In August 2009, RBS told us that since October 2008 it had announced the loss of 16,000 jobs across the global Group of which approximately 10,000 would be lost from the UK.[59] These losses announced included 2,700 from Global Banking and Markets,[60] 4,500 from Group Manufacturing,[61] and 2,300 from RBS UK, and a "number of smaller more localised announcements."[62]

56 Q 543

57 EV 133

58 Evidence from the Scottish Executive to the Economy, Energy and Tourism Committee, www.scottish.parliament.uk/s3/committees/eet/inquiries/banking

59 Ev 130

60 Ev 123

61 Ev 122

62 Ev 123

40. When giving evidence to us in 2009, Gordon Pell, then Deputy Group Chief Executive and now Chairman, Regional Markets of RBS, admitted that "along with virtually every business in this country we are going to have to realign our costs to our income." The Global Banking and Markets business had been the part of the bank that had suffered the early job cuts, with significant numbers of staff being shed in Asia and America.[63] Gordon Pell said that the approximately 18,000 staff working for RBS in Scotland would be less affected by the job cuts being made than the rest of the UK as they mainly worked in the retail and insurance businesses which were already "pretty lean".[64] He acknowledged that none of these staff were responsible for the position that the bank found itself in.[65] In March Mr Pell was unable to give us an exact figure for the job losses in Scotland but he guessed around 260.[66]

41. RBS wrote to us in August 2009 to confirm that 3,100 of the 7,400 UK job losses announced outside of the investment part of the Group had been implemented. Less than 25% of the job losses had been compulsory redundancies.[67] The memorandum to the Committee told us that the Strategic Plan for restructuring RBS would "remake" the bank.[68] On 2 November RBS announced that it had started the process of restructuring its Retail Banking division which would result in approximately 3,700 jobs from its branch network. It stated that it would provide opportunities for flexible working, job-sharing and redeployment where possible. [69]

42. In its memorandum to the Committee, Lloyds Banking Group stated that it had generated over £100 million of cost savings in the first six months after the merger of Lloyds TSB and HBOS. Lloyds has said that it was inevitable that the merger of the two banks would lead to branch closures and job losses to avoid duplication of roles.[70] On 10 November 2009, it was reported that Lloyds had announced that 1,000 posts would be cut in Scotland over the next year, with a net reduction of around 500 staff (this was amongst 5,000 UK jobs being lost by the end of 2010).[71]

43. Both RBS and Lloyds are being forced by the European Commission to sell off parts of their businesses, including:

- For RBS, 318 branches UK-wide (14% of its UK retail network)
- For Lloyds Banking Group, 600 branches (20% of its branch network and 4.6% of the current account market), including Cheltenham & Gloucester and Lloyds TSB Scotland.[72]

63 Q 202

64 Q 225

65 Qq 189–190

66 Q 237

67 Ev 130

68 Ev 156

69 "RBS Jobs Announcement", RBS News Release,2 November 2009

70 Ev 144

71 "Lloyds confirm a further 1000 scots jobs to go", *Daily Record*, 10 November 2009, www.dailyrecord.co.uk

72 "Darling defends bank reforms and £39bn infusion as good value", *The Guardian*, 3 November 2009, guardian.co.uk

44. Unite told the Committee on 2 December that there would be no let up in the job losses announcements:

> […] in terms of those two companies particularly, in terms of the Lloyds Banking Group and the Royal Bank of Scotland, in terms of some of their internal structures they are so determined to reduce their overall costs that there appears to be, certainly from the discussions we have had with them, absolutely no appetite for slowing down. They are going to press ahead with their restructuring plans and certainly from the discussions also that we have had with the Treasury and certainly UKFI that message comes across loud and clear, that these job losses will be implemented and that the businesses will be significantly restructured.[73]

45. In March we had heard that the unions had only been given limited information on the extent of job losses in RBS and Lloyds Banking Group by those banks.[74] In December, morale amongst staff was described to us as being "at a low ebb" particularly as, apart from a few publicised casualties, those responsible for the financial crisis were still in post.[75] The unions told us that a proper consultation programme was in place, but whether there was adequate consultation was questionable. The unions were working hard to try and manage expectations and help staff through the difficult situation.[76] Stephen Hester of RBS admitted in December that he had not met the National Officer of Unite, but told us that despite this RBS worked extensively with Unite across a wide range of areas.[77] Archie Kane of Lloyds Banking Group said that they aimed to keep staff as fully informed as possible and to engage in a constructive way with the unions involved.[78] He said that Lloyds had a "good professional relationship" with all three unions for Lloyds staff and a "very open and regular dialogue."[79] Lloyds had also met the Scottish Finance Sector Jobs Taskforce, the organisation set up by the Scottish Executive to co-ordinate efforts across Scotland to ensure maximum levels of employment were retained within the financial services industry.[80]

46. **It is clear that because of the mismanagement by senior executives of RBS and HBOS, modestly paid staff in the customer-facing retail services of those banks have suffered, and will continue to suffer many months of uncertainty over their future employment. These staff are not to blame for the risks taken by the banks and yet they face the brunt of public's anger at the less than favourable current economic conditions. Whilst it would be unlikely to expect cordial working relationships between unions and banks during this period of restructuring, we are disappointed to hear that the unions consider that they have not been kept fully informed of developments. We would expect banks to make every effort to provide unions with the latest information as soon as it is available and we intend to keep a watching brief on this matter.**

73 Q 566

74 Q 76

75 Qq 572, 574

76 Q 567 [Wendy Dunsmore]

77 Q 614

78 Q 690

79 Qq 695, 697

80 Q 688

Pressure on staff

47. STUC's written evidence to us stated that sales targets for staff have not been reduced as a consequence of the crisis. If staff do not sell these products, they will find themselves performance managed out of a job, sometimes in as little as 12 weeks.[81]

> There has been absolutely no material change to the culture within most of these institutions, particularly within the retail banking sector. Staff are still required to sell the same type of products to the same level, they are still performance managed within these organisations. This is not just to achieve bonus payments, this is simply to achieve your performance standard, and we have to deal with far too many cases of individuals who are being essentially performance managed out of the organisation, not because they commit acts of wilful misconduct but because they fail to sell sufficient products to customers. This is despite the fact that we are in the middle of an economic recession, it is despite the fact that consumers are being much more cautious now about the type of financial products that they are taking out, but there is still this drive on the part of the employers to push retail financial services products to the public and use their frontline staff, some of their lowest paid staff, to deliver those sales[82]

48. Sales targets tend to be based on a points system, with products such as credit cards and insurance weighted higher than deposit taking products. Whilst the unions acknowledge that targets are not being increased, there is no evidence that they are being reduced.[83] Unite stated that there were issues relating to targets at a local level which had led to bullying and harassment, unpaid overtime and an increase in stress levels. Unite believed that there was a risk that staff could be driven into dysfunctional selling in order to reach targets.[84] Unite also told the Committee that some staff were forced to take out their own products with the bank they worked for in order to reach their monthly targets.[85]

49. Whilst Lord Myners told us that it was not for the Government to commercially direct institutions or become involved in issues around individual performance targeting, he did say that:

> banks need to be constantly mindful of the fact that their business will prosper best if they provide a good service of good-value products to their customers and, to do that, they must know their customers and they must only sell to their customers products which are appropriate to that customer's requirements. I would hope that the new management of both the Lloyds Banking Group and the Royal Bank of Scotland would recognise that in the directions they are giving there.[86]

50. Archie Kane from Lloyds argued that they constantly reviewed and changed the level of performance targeting in view of the economic and competitive environment, but also the

81 Q 551
82 Q 550
83 Ev 167
84 Ev 167
85 Q 579
86 Q 775

direction that the bank wished to take in its strategy. As a result, savings currently had a higher weighting and loans had a lower weighting.[87] Mr Kane also said that under-performing staff were counselled and coached on performance improvement programmes. Sales of products were carefully monitored on a branch or area basis to pick up on any unusual sales statistics.[88] He also stated that very few people were performance managed out of their jobs, and that the performance management programme which would lead to their dismissal would take nine months to do so.[89]

51. Stephen Hester from RBS said that "throughout the business we are looking at how staff are incentivised to try to strike the right balance across the range of different behaviours that we want as a business."[90] However, he was unapologetic on the subject of performance targets:

> If staff members are not up to the job we have a responsibility to all the taxpayers, frankly, for having people who are up to the job. All of these things are about maintaining a very difficult balance, trying to get the recovery of RBS and trying to have good staff whilst understanding all the pressures all of our staff are under, and it is a series of difficult balancing acts.[91]

Mr Hester confirmed that whilst sometimes RBS got it wrong, throughout the bank an emphasis had been put on savings and as a result, RBS was outperforming its competitors in this area.[92]

52. Unite told us that staff were unable to negotiate the performance targets with management in either bank. The union was also concerned that it was unable to obtain statistics from RBS on disciplinary hearings due to performance.[93]

53. Citizens Advice Scotland has provided us with examples of their debt clients being encouraged by bank staff to take out further products, usually unnecessarily, as part of their repayment, including further loans, credit cards and overdrafts.[94] **We conclude that there is cause for concern that the same pressure is being put on front-line staff to sell products, including non-savings products, to customers at pre-recession levels or risk being performance managed out of their jobs. We agree with the unions that there is a danger that customers in debt could be persuaded by bank staff desperate for a sale to take out unsuitable products. We recommend that the regulatory authorities pay close attention to the banks' weighting of their products and performance management schemes in order to ensure that RBS and Lloyds are meeting their commitments to treat their customers fairly.**

87 Q 715

88 Qq 718–719

89 Q 720

90 Q 606

91 Q 629

92 Q 630

93 Ev 166

94 Ev 161

Bonuses paid to high earners

54. The remuneration paid to bankers both before and after the start of the banking crisis has been the subject of much public discussion. The majority of staff working for RBS and Lloyds Banking Group are paid relatively modest salaries with either small or no bonuses at all. However, many people are appalled at the very large bonuses that are reportedly being paid to bank executives and other high earners, especially those in receipt of tax payers' money. In its submission to the Committee, Unite stated that it was:

> [D]isappointed that excessive remuneration packages continue to be awarded to senior level executives in those companies who are partly owned by the Government and where influence could be wielded. The news that RBS has appointed two senior executives on remuneration packages amounting to around £10 million. This has raised concern with our members who see a "business as usual" attitude at the highest level with little intervention by UK Financial Investments (UKFI) to control such pay awards.[95]

55. The often-repeated argument of the banks for paying such high salaries to certain sections of their workforce, usually the investment banking divisions, was that they were only paying the going rate. When Gordon Pell of RBS gave evidence to us in March he admitted that his salary of £908,000 sounded "ludicrous" to many people but argued that his remuneration ranked similar to his peers around the world.[96]

56. In return for taxpayer support, both Lloyds and RBS have agreed to not pay *discretionary* cash bonuses in relation to 2009 performance to any staff earning above £39,000. In addition executive members of both boards have agreed to defer all bonuses payments due for 2009 until 2012, to ensure that their remuneration is better aligned with the long-term performance of their banks.[97] UKFI will have a right of veto over bonuses paid to RBS. HM Treasury has said it would do this if it was in the interests of taxpayers.[98] However, press reports in December 2009 suggested that Lloyds Banking Group would award up to 200 staff one-off payments of up to 80% of their annual salaries. The Lloyds bonuses were thought to include £2.4m for the board and £828,000 for chief executive Eric Daniels.[99] The RBS board were reported to have claimed that they would resign if they could not give between £1.5 and £2 billion worth of bonuses this year because it would not be in the interests of shareholders.[100] However, Stephen Hester explained to the Treasury Committee that this was not the case:

> we had to publish a very detailed and lawyerised prospectus for the Asset Protection Scheme and part of the legal drafting in that prospectus made the point that, as with all boards, the Board of RBS has a legal duty under companies law to shareholders

95 Ev 141

96 Q 195

97 "Implementation of Financial Stability Measures for Lloyds Banking Group and Royal Bank of Scotland", HM Treasury Press Notice 99/09,3 November 2009

98 "Bankers 'need to join real world', Minister says", *BBC News Online*, 3 December 2009, news.bbc.co.uk

99 "Lloyds sparks fresh row over bonuses", *digitallook.com*, 4 December 2009

100 "Bankers 'need to join real world', Minister says", *BBC News Online*, 3 December 2009, news.bbc.co.uk

> and a legal duty under regulation to the FSA to manage the business both in risk terms safely from an FSA perspective and in the shareholders' interests, and I think the legal drafting made the point that there were some aspects of operational freedom that were signed away by the Board as part of APS to the Treasury that if misused in the hands of the Treasury could make it hard for the Board to discharge its legal and regulatory duties. I think out of that legalese—and there was lots of other legalese in that document—came that particular story.[101]

57. On the 9 December 2009, when delivering the Pre-Budget Report, the Chancellor of the Exchequer announced a special one-off levy of 50% on any individual discretionary bonus above £25,000 that was being introduced in order to "claw money back for the taxpayer". This levy would be paid by the bank not the individual. He criticised banks who were still paying large bonuses to their executives:

> [t]here are some banks who still believe their priority is to pay substantial bonuses to some already high-paid staff. Their priority should be to rebuild their financial strength and increase their lending, so I am giving them a choice: they can use their profits to build up their capital base, but if they insist on paying substantial rewards, I am determined to claw money back for the taxpayer […] On a cautious assumption, which includes our expectation that some banks will rein back on bonuses, this levy is expected to yield just over £500 million.[102]

58. Both RBS and Lloyds have argued that in order to repay taxpayers' money in the long term, it was necessary to pay large salaries and bonuses in order to recruit and retain high performance staff. Stephen Hester told us on 2 December:

> I do think that there is a tightrope to be walked on this issue and I would agree with you that if RBS is unable to retain and motivate staff in any part of RBS it will be very difficult to fulfil our goal of making the bank safe, because if you do not have good staff you cannot have a safe bank, of serving customers, because if you do not have good staff you cannot serve customers, or of the taxpayer having any chance to get their money back.[103]

59. He further explained to the Treasury Committee on 12 January :

> as a shareholder-owned company, we want to pay our people the minimum possible consistent with keeping them engaged, motivated, and doing the things the shareholders want them to do, so part of that is how well our people have done against the tasks they have been set and part of it is how the market against which they compare themselves remunerates.[104]

101 Oral evidence taken before the Treasury Committee on 12 January 2010, HC 259-i, Q 21 [Stephen Hester]

102 HC Deb, 9 December 2009, col 367

103 Q 616

104 Oral evidence taken before the Treasury Committee on 12 January 2010, HC 259-i, Q 17 [Stephen Hester]

60. Similarly, Archie Kane told us on 9 December: "If organisations—and this applies to any significant bank—cannot pay competitively, there is a high chance it will lose key staff. I do not think there is any doubt about that."[105]

61. Lord Myners had previously said that banks should "come back into the real world", as much of the profit they were making was due to the "benign conditions" created by the Government pumping billions of pounds into the economy.[106] However, when giving evidence to us on 13 January, Lord Myners acknowledged the argument made by RBS and Lloyds:

> Royal Bank of Scotland's Global Market and Banking Division is a very profitable source of activity at the moment. It is operating in a sector of the industry which is producing very good returns on capital and, to achieve that, they need to be able to ensure that they can recruit, retain and motivate the people they require […] I do not know if it is in the interests of the banks or the taxpayer for those banks to not have the necessary skills to manage their business and manage their risks responsibly.[107]

Lord Myners made an analogy to Premier League football, and said that you had to pay for the best players if you wanted to stay at the top of the League. "There is a market and, from my own perspective, the levels of payment in those markets are extraordinary, but the Royal Bank of Scotland cannot redefine the world alone".[108] He also considered that preventing the banks from paying the going rate for staff could affect its long term viability:

> if we said to the Royal Bank of Scotland, "You can only pay your key employees up to the national average earnings" or twice the national average earnings or some other arbitrary figure, the effect would be a significant erosion in the competitiveness of that bank, a loss of ability to revive credit, a loss of employment, particularly in Scotland, and a decline in the stature of the bank.[109]

62. When asked what the Government had done to tackle the issue of remuneration, Lord Myners stated that the introduction of the levy on bonuses was one way in which the Government had drawn attention to the risk that the compensation culture has had on banking. It had also introduced the Financial Services Bill in November 2009 which placed a statutory obligation on the Financial Services Authority to take a bank's remuneration policy into consideration when evaluating a bank's capital levels.[110] Lord Myners added that the Prime Minister and Chancellor of the Exchequer were also trying to push the world banking system towards a new approach to remuneration which put more emphasis on compensation being provided in shares held in the long term, deferring the receipt of the benefit. This way, in cases where the passage of time showed that an individual or team had performed less well than initially believed, the benefit could be clawed back. However,

105 Q 709

106 "Bankers 'need to join real world', Minister says", *BBC News Online*, 3 December 2009, news.bbc.co.uk

107 Q 757

108 Q 759

109 Q 763

110 Q 761

Lord Myners argued that the UK Government could not change the culture and remuneration structures of global investment banking on its own. [111]

63. **Whilst it is not within the remit of this inquiry or this Committee to make recommendations on suitable remuneration for bank executives, we conclude that it is disappointing that the Scottish banks in receipt of tax payers' money continue to pay large remuneration packages to senior level executives, particularly when the rank and file bank employees on modest incomes are in fear of losing their jobs.**

Bank lending

Availability of finance for businesses

64. Official Scottish Executive statistics show that Small and Medium-sized Enterprises (SMEs) now account for 99% of all Scottish businesses and for 53% of all private sector employment. In early 2009, lending to consumers and small businesses was well down when compared with the previous year.[112] The Treasury Committee commented on the evidence it received in this regard saying, in particular, that the increases in bank charges for business customers was especially damaging:

> We regret the reports of sharp increases in bank charges and arrangement fees which can often be more damaging to businesses than higher interest rates. We deplore the behaviour of a number of those banks who have received so much public money and behaved in such an insensitive manner particularly to established customers. [113]

65. We took evidence from the Federation of Small Businesses (FSB), Scotland and the Law Society of Scotland on the impact of the banking crisis on SMEs in Scotland. CBI's written evidence to us stated that its "UK wide Access to Finance Survey" suggested a marginal improvement in the availability of finance to businesses. It also told the Scottish Parliament Economy, Energy and Tourism Committee that there had been an increase in the availability of credit lines to very large organisations with a more modest increase for SMEs.[114]

66. However, in November 2009 the FSB published its Report "Research into Job Losses in Small and Micro Businesses" which concluded that small and micro businesses have faced challenges on several fronts including: decreases in demand; increases in late payments; and reduced access to affordable finance. In combination, the FSB found that those factors had severely impaired the cash flow in the majority of businesses consulted.[115]

67. The Scottish Executive published a study in July 2009 on access to finance for SMEs which found there was a significant gap between the demand for finance from Scotland's small businesses and the willingness of high street banks to provide it. It also found that

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111 Q 762

112 Treasury Committee, *Banking Crisis: dealing with the failure of UK banks*, para 182

113 Treasury Committee, *Banking Crisis: dealing with the failure of UK banks*, para 189

114 Ev 134

115 "Research into Job Losses in Small and Micro Businesses", *FSB Scotland and Slims consulting*, November 2009, p 5

75% of the SME market in Scotland is in the hands of either RBS or Lloyds Banking Group.[116] On 9 February 2010 the Scottish Executive published an update to its study which reported that of the SMEs surveyed, the majority said that the ease of obtaining finance remained unchanged since March 2009. The study suggested that banks appeared to be more willing to lend to viable business propositions, but lower amounts of finance were being obtained.[117]

68. In its evidence to us, the FSB stated that 30% of businesses had reported an increase in the cost of existing credit. It acknowledged that the availability of finance had improved, but that the cost in terms of conditions and fees was still very high. FSB members felt that banks were "finding new ways to charge", such as "security" sums for credit card facilities.[118] The manufacturing and agricultural sectors had experienced particular difficulties.[119] It was also suggested by Law Society members that good businesses were simply being used to raise money for the ailing banks.[120]

69. Colin Borland of the FSB Scotland told us that the FSB had created a financial advice hotline to assist businesses in preparing loan applications. The FSB also provided a free financial health check to its members.[121] He explained to us the problems facing businesses:

> A year ago the question was access to finance; of somebody wanting a loan for a perfectly valid business or a perfectly valid proposition, which is going to make money for themselves, the bank and the company, but not being able to access it. […] The questions now are around the cost of finance. We are seeing about 30% of members reporting a cost increase of existing finance, including their overdrafts; and about 26% […] reporting an increase in cost of new finance.[122]

70. The Law Society Scotland provided evidence that long term clients of HBOS and RBS had been presented with unreasonably high fees for finance applications and renewals, and were being offered renewed finance on terms far less favourable than previously for no obvious reason. Mr Norman Banski, Council member and a member of the Professional Practice Committee of the Economic Impact Group of the Law Society Scotland told us:

> One client […] approached one of the banks four months ago to obtain funding to carry out a small-scale development. They had never had any debt with that particular bank, and four months later, after they had started the work on the basis that they had been given a fairly broad nod that it would be okay, they were told that they were getting no support, so they have had to resort to private funding to source the costs. Another client has advised me that he has been charged double charges on

116 Q 485, "SME Access to Finance 2009", Office of the Chief Economic Adviser, July 2009, www.scotland.gov.uk

117 "SME Access to Finance—Update Survey November 2009", Office of the Chief Economic Adviser, February 2010, p 3,www.scotland.gov.uk

118 Ev 146

119 Ev 142, Q 464

120 Ev 143

121 Q 457

122 Q 453

> arrangement fees and 4% above base, rather than 2% as would have been the norm before the crisis. This seems to be echoing throughout the profession.[123]

71. FSB Scotland published a survey in February 2010 which reported that 23% of firms surveyed had cited problems with obtaining affordable finance and more than a fifth of firms surveyed had dug into their own savings over the past year. A spokesman for FSB commenting on this said “the cupboard marked ‘emergency’ is bare”.[124]

RBS and Lloyds Banking Group commitments to lending

72. In return for taxpayer support, RBS and Lloyds Banking Group had agreed to certain lending commitments. These included increasing lending to businesses and homeowners by a total of £39bn for both banks and introducing a “customer charter” for lending SMEs to meet all “reasonable applications for finance from viable businesses”.[125] Lord Myners told us the customer charters would show on what terms the banks were offering credit.[126] The banks also had to commit to maintaining over the next three years the availability and active marketing of competitively priced lending to homeowners and small businesses at 2007 levels. On 3 November 2008, HM Treasury announced that UKFI would also oversee those conditions (this subsequently reverted to HM Treasury who will monitor the lending commitments and will report on them annually to Parliament.). In his announcement, the Chancellor said:

> In addition to the recapitalisation fund and the credit guarantee scheme, the Government will continue work to ensure that all lenders do everything they can to support homeowners and small business during this period of financial market turbulence.[127]

73. In addition, it was announced on 25 November 2008 that a Lending Panel had been established to meet monthly and “monitor lending to both businesses and households, and to promote best practice across the industry in dealing with borrowers facing financial difficulties. It is comprised of Government, lenders, consumers, debt advice and trade bodies, and regulators and the Bank of England.”[128] The Governor of the Bank of England told the Treasury Committee that “the lending agreements need to be specified in quantitative form so they can be monitored.”[129]

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123 Q 456

124 “Small firms use own savings due to lack of bank credit”, *BBC News Online*, 1 February 2010, news.bbc.co.uk

125 “Implementation of Financial Stability Measures for Lloyds Banking Group and Royal Bank of Scotland”, HM Treasury Press Notice 99/09,3 November 2009. See RBS charter at www.rbs.com/media/sme-charter andLloyds Banking Group Charter at www.lloydsbankinggroup.com/media1/media_campaign.asp

126 Q 767

127 “New company to manage Government’s shareholding in banks”, HM Treasury Press Notice 114/08, 3 November 2008

128 “Statement on banks and building societies”, HM Treasury Press Notice 126/08, 25 November 2008

129 Treasury Committee, *Banking Crisis: dealing with the failure of the UK banks*, para 193

Specific RBS commitments to lending

74. In written evidence to the Committee, RBS stated that it was committed to make an additional £25bn of lending available to meet creditworthy demand from households and businesses in the UK. This funding was split between £9bn on mortgages, and £16bn on lending to small, medium and large businesses.[130] It had made an extra £3bn available through its Regional SME Funds initiative including a £250m fund for Scotland. New lending to SMEs in Scotland had surpassed £1bn since the beginning of the year and RBS's total outstanding lending was currently up 3.6% over this period. RBS told us that it approved 85% of all applications for SME lending it received (which was the same percentage as before the financial crisis). However, it stated that the demand for credit was falling. In 2009, borrowing requests by SME customers had declined by 37%.[131] Stephen Hester told us in December that RBS had made a total of £45 billion in new loans to business customers in the UK.[132] However, RBS still had £27 billion worth of undrawn overdraft finance to companies.[133]

Specific Lloyds Banking Group commitments to lending

75. In its written evidence to us, Lloyds said that Lloyds TSB substantially increased its lending in both areas in 2008, albeit from a far smaller base than HBOS. HBOS had severe liquidity problems in 2008, and therefore major constraints on its ability to lend, and had essentially withdrawn from the market.[134] As part of the Lloyds Banking Group, the Bank of Scotland was now able to lend again and claimed to be an active participant in the government's Enterprise Finance Guarantee Scheme.[135]

76. On 9 November, Lloyds launched a "2012 SME Charter", committing to a "3-year program of support" for SMEs.[136] It has committed to helping 300,000 new SMEs start up over this time and provide support to help them grow. The initiative was aimed at the Group's business customers with a turnover of up to £15 million. The announcement on the 2012 Charter also said Lloyds would "clarify the terms on which the Group will lend to its customers". Archie Kane told us that they would not change their fees for existing customers unless the credit situation of those customers changed.[137]

77. Archie Kane told the Scottish Parliament's Economy, Energy and Tourism Committee (EETC) on 2 December 2009 that Lloyds had agreed with the UK Government that it would provide an additional £28 billion of lending over 2 years, £14 billion per annum, but that the difficulty in the corporate and commercial sector was that demand was not as strong and robust as it previously had been. He emphasised that Lloyds was intent on being

130 Ev 157

131 Ev 157

132 Q 632

133 Q 633

134 Q 722

135 Ev 144

136 "Lloyds Banking Group launches '2012' SME Charter", Lloyds Banking Group press release, 104/09, 9 November 2009, www.lloydsbankinggroup.com

137 Q 724

available to lend to the SME market. In addition to the drop in demand for lending, he also said there were situations where funds were agreed by the bank but were not drawn down.[138] On 9 December when he gave evidence to us, he said that application rates for business loans had dropped 20% year on year. Lloyds was converting 85% of applications into loans.[139] Mr Kane also told us that in order to get the message across that Lloyds Banking Group was open for business again; they had contacted existing customers and had run approximately 200 business banking seminars throughout the UK. Mr Kane made clear that Lloyds Banking Group would be using the risk management approach of Lloyds TSB and not HBOS of the past which would mean that certain customers would not fit their credit profile and there was a risk that those customers would be turned down.[140] However, Lloyds had a "business support unit" which was there to work with existing customers who hit problems and return them to good health.[141]

Definition of a "viable business"

78. Colin Borland of FSB Scotland acknowledged that whilst banks had agreed to grant "reasonable applications for finance from viable businesses", they were now taking more risk averse decisions on what constituted a "viable" business.[142] Lloyds' written evidence to us also said: "There is considerable public pressure on banks which are in receipt of taxpayer funding to simultaneously lend money to those who need it and to lend responsibly in order to mitigate against future losses for individuals and for the Group."[143]

79. Robin Haynes, Head of Financial Services at the Scotland Office, was aware of anecdotal evidence that small firms were finding difficulty in gaining credit. He quoted Owen Kelly, Chief Executive of Scottish Financial Enterprise, who had said that because the situation of borrowers had changed and the level of risk attached to lending to them had increased as a result; It was important that banks recognised those changing risk profiles to avoid a recurrence of the mistakes made in the past.[144]

80. David Thorburn of Clydesdale Bank acknowledged that there had been some re-pricing of loans at his bank:

> Only a very small percentage of our term loans have been re-priced in the last year. 14% of our term loans have been re-priced in the last 12 months. A considerably high percentage of overdrafts have been re-priced, but in all cases that has been by face-to-face negotiation. It is necessary for the banks to re-price some facilities that are related to base rate because if that did not happen the banks would be losing

138 Official Report of the oral evidence taken before the Scottish Parliament Economy, Energy and Tourism Committee on 2 December 2009, col 2782–83

139 Q 722

140 Q 723

141 Q 731

142 Q 467

143 Ev 144

144 Q 768

> money […]The cost of our raw material funding has gone up and we need to try and share that burden with our customers.[145]

He told us that whilst some banks were open for businesses, many SMEs operated in sectors where banks had less of an appetite to lend in an economic downturn, e.g. property or motor traders sectors which were more vulnerable in a recession.[146] Stephen Hester of RBS agreed, noting that small businesses were often shopkeepers and their primary asset was the building in which the shop was based. As the property sector had been hard hit by the economic crisis, this would affect such businesses and their ability to raise finance.[147] He went on to argue that the era of easy money for businesses was over:

> What we simply have is a shift in power in the world from borrowers to savers. The world was awash with money being thrust at people who borrowed and they achieved it on unrealistic terms in past years, and that is why we are in the trouble we are in. With the shift in power, what crudely is happening is that savers' money is more valuable so they can demand more for it and borrowers have to take up the slack and banks sit in the middle.[148]

81. Rather than refuse to lend, RBS now attached more strings to lending than it had done in the past. In addition to the publication of their new SME charter, RBS was visiting professional bodies around the country and Chambers of Commerce to explain the charter.[149] Mr Hester also cited the RBS business hotline for people turned down both by RBS and also by other banks as further evidence of RBS trying as hard as it could to support viable businesses.[150] However, he acknowledged the difficulties facing businesses seeking finance today:

> I completely understand that borrowers are having to go through, if you like, a shock from a world where money was flowing everywhere and being thrust at people to borrow to a world where the pendulum has swung back a lot the other way. It is not only an opinion, it is cast iron fact that the banks lending to businesses in this country are making less profit than before and not more[…].[151]
>
> We must all be really crystal clear that a safer economic system, a safer country and safer banks by definition means less credit and a higher cost for credit across the economy; you cannot have one with out the other. If we want a safer banking system and a safer economy we must understand that credit will be harder to get and more expensive.[152]

82. David Thorburn of Clydesdale Bank agreed: "At the end of the day one of the key causes of the credit crisis was systemically under-pricing risk and a necessary unfortunate

145 Q 631 [Mr David Thorburn]

146 Q 634 [Mr David Thorburn]

147 Q 635

148 Q 631 [Mr Stephen Hester]

149 Q 647

150 Q 639

151 Q 646 [Mr Stephen Hester]

152 Q 648 [Mr Stephen Hester]

consequence of that was this re-pricing.”[153] Archie Kane of Lloyds Banking Group believed that: “Regulators are going to insist on much more risk management and a much more risk-based approach to pricing, for example, and regulators are also going to insist that increased levels of capital are applied against the various risk sections of a business.”[154]

83. Adrian Coles of the Building Societies Association acknowledged, however, that there was “a danger that lenders had become over-cautious”. He believed that the FSA was in a “very cautious mood” as were credit agencies: “I think they rated some things triple-A in the boom years that they should not have rated triple-A and they are probably rating some things single-B now that do not deserve such a low rating.”[155]

84. The Committee of Public Accounts’ recent Report, *Maintaining financial stability across the United Kingdom’s banking system*, concluded that lending commitments to businesses were not being met but that HM Treasury could not explain why this was the case as interpreting the lending data was difficult.[156] It recommended that the Treasury should devise effective and enforceable sanctions if the banks continued to fall short of their commitments.[157]

85. **We conclude that whilst the banks insist they are open for business, a significant amount of SMEs in Scotland still appear to be struggling to gain access to affordable finance. Whilst we agree that banks must take a more responsible attitude towards lending than they had in the past, banks in receipt of taxpayers’ money now have an obligation to explain their decisions on lending to businesses applying for finance. In future we would expect the FSB Scotland to be able to tell us that their members fully understand the reasoning behind the terms on which they have been offered finance.**

Lending to homeowners

86. The Bank of England’s Agents’ summary of business conditions in November 2009 stated that housing market activity remained above the very weak levels prevailing a year ago, but with first-time buyers still described as scarce, reflecting the tightness in mortgage availability for those without substantial deposits.[158] A report from Homes for Scotland published in February 2010 concluded that Scotland was facing a housing crisis, with lack of finance and access to mortgages holding back a recovery. The number of new homes being built had fallen from 25,000 before the recession to 15,000 in 2009.[159]

87. The Chartered Institute of Housing stated that Scottish house purchase lending had been falling at a higher rate than in the UK as a whole and the deposit needed by first time

153 Q 646 [David Thorburn]

154 Q 724

155 Q 648 [Adrian Coles]

156 Public Accounts Committee, 12th Report of Session 2009–10, *Maintaining financial stability across the United Kingdom’s banking system*, HC 190, p 5

157 Public Accounts Committee, *Maintaining financial stability across the United Kingdom’s banking system,* p 9

158 “Agents’ summary of business conditions”, Bank of England, November 2009, www.bankofengland.co.uk/publications

159 “Housing crisis in Scotland 'worst since WWII'”, *BBC News Online*, 9 February 2010, news.bbc.co.uk

buyers was (by first quarter of 2009) typically 25% compared with 12% previously.[160] Norman Banski of the Law Society of Scotland told us that first time buyers were finding the rate of stamp duty a challenge, as were builders and developers.[161]

88. The Building Societies Association (BSA) noted that "very low interest rates have drastically reduced individuals' incentive to save, restricted the flow of funds to the mortgage market; and squeezed building societies' margins." It considered that "quantitative easing", designed partly to increase the flow of funds in the economy, had not resulted in new flows in these markets. Indeed, BSA suggested that banks were hoarding these flows, with substantial increases in their cash held with the Bank of England (up from £31 billion in March 2009 to £136 billion in August), rather than using QE money to increase their lending.[162] The Bank of England notes that quantitative easing will still have a beneficial effect, even if banks don't expand their lending, although it will be less powerful than it would otherwise be.[163]

89. According to the BSA, building societies were under pressure to hold increased levels of capital to cover the possibility that they might make further losses on the loans which they currently hold, or might hold in the future. Other ways of reducing risk also have an impact on lending availability, for instance, in the mortgage market, where borrowers are asked for large deposits and loans are withheld from individuals with even the slightest blemish on their credit records. Adrian Coles of the BSA told us that building society profitability in relation to the size of the business had halved in 2008:

> The key issue for building societies is funding and the funds are just not available at the moment […] there are virtually no additional deposits available in the economy this year and there is very severe competition for those deposits from institutions such as National Savings […] Building societies are almost unique in having very little support from the taxpayer and that makes it very difficult for them to compete in the market. When they do lend they tend to be more conservative and careful on their lending now, there is far less 90%-plus loan-to-value ratio lending than used to be the case.[164]

90. RBS had lent over £7bn in new mortgages across the UK and has had £3bn repaid in the first half of 2009. In March it announced £1.7bn worth of new mortgage lending will be made available in Scotland during 2009. To the end of July, £855m had been lent and RBS believed that it was on track to achieve the £1.7bn by the year-end. A similar sum was likely to be pledged to the Scottish market in 2010. The Group Chief Executive of RBS told the Scottish Parliament Economy, Energy and Tourism Committee that in Scotland, 17% of RBS's mortgage lending was to first time buyers. RBS was only lending up to a 90% loan to value ration and 90% of those who applied, got their mortgages.[165]

160 Ev 125

161 Q 478

162 Ev 151

163 Bank of England online guidance on Quantitative Easing, www.bankofengland.co.uk/monetarypolicy/qe/askqa.htm

164 Qq 634, 636

165 Official Report of the oral evidence taken before the Scottish Parliament Economy, Energy and Tourism Committee on 25 November 2009, col 2730

91. Clydesdale Bank claims “a long and well established record of prudent and conservative credit management in growing its business.” It has never offered 100+% or “self-certified” mortgages, while its average Loan to Value for all mortgages (on an unindexed basis) was 63%.[166]

92. Archie Kane of Lloyds Banking Group told us that the Group had reduced the loan to value ratio of its mortgage lending, as had the rest of the market. On the question of repossessions made, he responded that arrears had increased, but repossessions had only increased slightly,[167] and that Lloyds’ priority was to get the customer back on track with payments rather than instigate repossession.[168] Lloyds Banking Group’s written evidence claimed that “[reducing impairment and] sympathetically managing borrowers in distress remain clear priorities of our business. We only consider repossession as a last resort. Our repossessions remain well below the Council of Mortgage Lenders industry average levels in 2009.”[169]

93. David Thorburn of Clydesdale Bank believed that his bank tried at all costs to avoid repossessions:

> The Council of Mortgage Lenders’ estimate of repossessions in the UK over the last 12 months is of the order of 45,000 or so and Clydesdale has had 25 in Scotland […] We also established a specialist unit in our regional office in Leeds which was staffed by experienced mortgage advisers to be available as a best practice centre for customers to phone up when they are experiencing financial difficulties or have lost their job, things of that nature. That unit is experienced and empowered to be able to help the customer negotiate an extension of terms and interest-only mortgages, things of that nature, to try and prevent the crisis from hitting the family too hard. In addition, we have had training and raised awareness amongst our frontline staff in branches of that centre of excellence but in general their approach is to try and help customers through this downturn rather than exacerbate the situation.[170]

94. The Building Societies Association told us that building societies remained committed “to helping those in arrears in every way they can, viewing repossession as the very last resort in the vast majority of arrears cases.” Adrian Coles of the Association gave us his view on why the rate of repossessions in the current recession was lower than expected:

> At the start of this year the forecast was 75,000 repossessions across the whole of the UK; the likely outturn now is less than 55,000. The reasons for that, I think, are very low sustained rates of interest, which are really supporting the mortgage market through a difficult period, lender forbearance, and lenders have learnt a lot from what happened in the early 1990s and are really bending over backwards in the way that David [Thorburn] suggested not to repossess, and, there is a lot more money going into the provision of independent debt advice. Research we have undertaken

166 Ev 131

167 Q 736

168 Q 737

169 Ev 174

170 Q 657 [David Thorburn]

> shows first of all the earlier you go to your lender the less likely you are to be repossessed.[171]

Mr Coles also praised Lord Myners and the Home Finance Forum which he believed had brought various government departments, lenders and trade associations together to discuss these issues with a beneficial impact.[172]

95. The Chartered Institute of Housing suggested that lenders should be encouraged to offer homeowners, where they are struggling, shared equity stakes rather than repossessing. They argued that struggling homeowners who can not fully service their mortgage, may be able to afford upwards of 50-60% of it.[173]

96. RBS had pledged not to initiate repossession proceedings for a full six months after a customer first falls into arrears to help customers who may be struggling to keep up their mortgage repayments through the recession.[174]

97. **We welcome the evidence we heard which suggests that banks and building societies view repossession as the last resort.**

Government support for businesses

98. As well as the lending commitments introduced as part of the negotiations with RBS and Lloyds Banking Group on the Asset Protection Scheme, the Government has taken other steps to support responsible lending to businesses. In the 2008 Pre-Budget Report the Government announced a £1bn Small Business Finance Scheme, which went live on 14th January 2009 as the £1.3 billion Enterprise Finance Guarantee Scheme (which replaced the Small Firm Loan Guarantee scheme). It was created to enable small firms (with turnover of up to £25 million) who could not access the finance they needed to secure loans of between £1,000 and £1 million. It was available until March 2010. HM Treasury estimated that "nearly £75.4m of eligible applications from 597 firms in Scotland have been granted, are being processed, or assessed."[175]

99. The Pre-Budget Report 2009 extended the scheme for another 12 months, and provided £500 million in additional support for businesses. The Federation of Small Businesses, Scotland believed that while certain elements of the scheme could have been improved (particularly around implementation), the initiative was welcome. On balance, the FSB believed this fund had been successful, although demand peaked quickly.[176] Colin Borland of FSB Scotland believed that it had removed the excuse not to lend to businesses.[177]

171 Q 657 [Adrian Coles]

172 Q 657 [Adrian Coles]

173 Ev 128

174 Ev 129

175 HM Treasury online information on the Pre-Budget Report, prebudget.treasury.gov.uk/scotland

176 Ev 146

177 Q 455

100. Clydesdale Bank stated that it was active in bringing this scheme to the attention of customers that could potentially benefit from it. While the Bank has approximately a 3% market share of UK SME lending, it had already lent over 8% of the funding provided under the EFG scheme.[178]

101. The Government also introduced the Working Capital Scheme with the aim of providing banks with guarantees covering 50% of the risk on existing and new working capital portfolios worth up to £20 billion. This was intended to assist firms by guaranteeing £20 billion worth of working capital credit lines for companies and would free up capital which the banks must use for new lending as a condition of this scheme.[179]

102. Small and medium-sized businesses can also benefit from up to £4 billion in loans from the European Investment Bank over the next four years. These would be made available through the banks, not directly to firms.[180]

103. In its 2009 Pre-Budget Report (PBR) HM Treasury announced new allocations from the Strategic Investment Fund for Scotland. Set up in April 2009, the fund supported advanced manufacturing and other hi-tech projects across the country including facilities for new life sciences companies in Edinburgh and a video games centre of excellence in Dundee.[181]

104. The Treasury Committee has commented on the difficulty of forming an understanding of how well all the efforts to encourage lending by banks are working together. It recommended that the Government, through its Lending Panel, ensure that there is a clear, published lending strategy in this regard. It also assessed the arrangements for the annual reporting of lending levels to be inadequate and recommended quarterly figures reported by banks to the Treasury be made public.[182] Colin Borland of FSB Scotland suggested that it was necessary to have an impartial observer such as the Financial Intermediary Scheme in England to mediate between banks and businesses and to report on patterns of lending within sectors.[183]

105. **Evidence to us suggested that the measures introduced by the Government to promote responsible lending have been welcomed. The Government must continue to monitor the levels of lending, particularly to SMEs to ensure that the pendulum has not swung too far the other way and that banks have become risk averse to businesses.**

178 Ev 132

179 Information taken from the Department for Business, Innovation and Skills website, www.bis.gov.uk/helping-businesses-through-the-recession

180 "Extra support for small firms in the UK from the European Investment Bank", HM Treasury Press Notice 112/08, 30 October 2008

181 "Pre-Budget Report for Scotland", HM Treasury press release, www.hm-treasury.gov.uk/prebud_pbr09_pressregindex.htm

182 Treasury Committee, *Banking Crisis: dealing with the failure of the UK banks,* para 189

183 Q 462

Fair treatment of customers

106. Consumer debt remains by far the most common single issue that clients bring to citizens advice bureaux: with almost nine out of every ten debt clients being in debt to their bank and the average amount of debt per clients being £20,000.[184] Citizens Advice Scotland (CAS) (the national umbrella body that provides essential services to Scottish citizens advice bureaux) told us that its clients (generally low income consumers) have found that banks are increasingly difficult to deal with, credit and mortgages more difficult to access, with banks taking a harder line on those in arrears and showing an unsympathetic attitude to customers suffering financial difficulty.[185] The CAS will advise debt clients and help them provide banks with financial statements of income and expenditure in order to come to an agreement with banks on the terms of their repayment. Banks can then be challenged by the CAS if they attempt to go back on these agreements.[186]

107. In its evidence CAS highlighted the following activities of banks as particular problems for their clients:

- Unfair overdraft charges;
- Banks being more aggressive in their behaviour towards debtors;
- Banks encouraging debtors to take out more products as part of their repayment;
- Banks demanding higher repayments from clients in order to repay debt quicker, and
- Banks are using the "right of set off" to (legally) transfer cash from current or savings accounts to pay off credit card or loan arrears without customers' permission.[187]

CAS thought that the unfair banking charges, irresponsible lending, unsympathetic attitudes to those experiencing financial difficulties and aggressive debt collection were all hallmarks of the pre-crisis UK. CAS believed that the effect of the banking crisis had been to worsen these problems for clients, and at the same time to introduce many more people to these poor practices.[188] It provided us with some of the worst examples of customer treatment by banks, a selection of which are provided in Table 1 below:

184 Q 501

185 Ev 160

186 Qq 506–507

187 Ev 160–161

188 Ev 162

Table 1

A CAB in the **West of Scotland** reports of:

- A client who incurred an overdraft of 70 pence after a company failed to cancel a Direct Debit as requested. Consequently she has incurred overdraft charges of £176 to date with £20 being added per day.
- A client who made a repayment offer to her creditors, and was instead offered a further loan. The loan would have helped the client to avoid default, but would have cost a further £2,700 in interest and charges. The client rejected the offer, and decided to stick to the repayment plan prepared by the bureau.

A CAB in the **North of Scotland** reports of:

- A client who is being harassed by her bank by way of frequent messages to her phone. The bureau is attempting to act on the behalf of the client, but the bank refuses or is reluctant to negotiate with the bureau, and is continuing to target the client directly.
- A lone parent whose bank are insisting that she increases her repayments on her overdraft to over four times the level she is currently paying. The client has an agreement to pay £66 per month, but now her bank is insisting on the overdraft being cleared in six months which would entail payments of over £300 which the client cannot afford.

Source: Citizens Advice Scotland

108. CAS argued that the solutions put forward to solve the financial crisis have mainly focused on introducing stability and liquidity into the existing system, as well as attempting to reduce risk taking in the sector. It believed that the customer-focused solutions introduced by the UK Government, such as the Homeowner Mortgage Support Scheme, have had a moderate impact on the tide of repossessions, with banks reportedly showing greater forbearance before bringing their customers through the repossession process.[189] Plans to curb the worst excesses of the credit card and Payment Protection Insurance (PPI) industries were also welcomed, although the benefits expected from these plans are yet to be felt by CAS's clients. Whilst there appeared to be less inclination on the part of banks to repossess property, CAS believed that there was more aggressive collection of repayment on other non-secured lending.[190]

109. Vida Gow, Money Advice Coordinator for CAS, told us that despite clients having spoken to CAS money advisers who then take up the clients' cases on their behalf, the banks still continued to call the clients daily asking for repayment.[191] Keith Dryburgh, Social Policy Officer, CAS, described this as "almost circumventing the advice process". He said that clients could be pressured into making agreements with the bank that they would not have done if the bank had dealt with the CAS adviser on behalf of the client.[192] CAS also thought that banks should be encouraged to open more basic current accounts to people who have been made bankrupt, to enable the debtor to draw a line and start afresh.[193]

110. In evidence to us on 13 January 2010, Lord Myners acknowledged that the regulatory authorities were now recognising that they had to go further to protect customers and to

189 Q 508

190 Q 503

191 Q 498 [Vida Gow]

192 Q 498 [Keith Dryburgh]

193 Q 511

require banks to make changes to their practices. Lord Myners had heard one case in particular where a customer of HBOS had received "dreadful treatment" which had been painful for the Minister listen to.[194] As a result of complaints, HBOS had changed its use of its automated computer telephone system known as "Triad" which had been responsible for the harassment of customers.[195]

111. Archie Kane, Group Executive Director, Insurance, Lloyds Banking Group, acknowledged that the activities described by CAS did happen, but he believed they were the exception rather than the rule.[196] He claimed that the Group had changed a number of its practices over the previous year, including trying to prevent barrages of silent calls to customers.[197]

112. Stephen Hester of RBS admitted that there were sometimes mistakes, but he believed that RBS made an effort to deal with its customers fairly.[198] He cited RBS's national financial and business skills programme for adults and children, "MoneySense",[199] as well as RBS's support of Citizens Advice, including allowing CAB advisers to sit in RBS branches, as evidence of this.[200] David Thorburn, Executive Director and Chief Operating Officer of Clydesdale Bank, said that Clydesdale did have an automated dialling system but believed that it was used responsibly, as was the right of set-off—although never without discussion with the client to try and find a way to avoid it.[201] Adrian Coles, Director General of the Building Societies Association, told us that the Association was a member of the Money Advice Liaison Group which brought together trade associations and elements of the money advice sector.[202]

113. **We conclude that banks continue to use aggressive tactics towards customers who have fallen into debt. We have heard from our own constituents of their terrible stress and anxiety at the repeated, often automated, calls from unsympathetic bank call centres. Whilst we acknowledge that customers must accept responsibility for their spending, we consider that banks, particularly those in receipt of taxpayers' money, have a special obligation to ensure that their staff do not use unduly uncompromising or unfair practices in their communications with their customers. We recommend that the banks use the research undertaken by Citizens Advice Scotland to identify specific areas in which they can improve their communications with customers.**

114. **We recommend that the regulatory authorities ensure that banks are monitored for bad practices in customer services to ensure that banks do not continue with, or develop further bad practices in these difficult economic times for both businesses and the general public.**

194 Q 771

195 Q 772

196 Qq 739–740

197 Qq 741–742

198 Q 658 [Stephen Hester]

199 Q 659 [Stephen Hester]

200 Q 665

201 Q 658 [David Thorburn]

202 Q 663

Funding for financial advice to the general public

115. The Financial Services Authority has been leading a National Strategy for Financial Capability since 2006 to help inform and guide both children and adults on how to manage money, keep track of their finances, plan ahead, choose suitable financial products and stay informed about financial matters. As well as generic web and print resources available through the FSA's consumer-facing website, including a guide available to new parents, which is also distributed via midwifes, and a financial seminar available to employees in their workplace, more targeted interventions have included funding three development officer posts at the Scottish Centre for Financial Education to help teachers embed a basic understanding of financial matters in the classroom.[203]

116. HM Treasury has recently given the go-ahead for the UK-rollout of an impartial money guidance service from 2010, branded "Moneymadeclear".[204] As announced in the Pre-Budget Report 2009, the rollout will be funded with £20m from Government and the FSA and will led by a new independent consumer financial education body to be established by the FSA under the Financial Services Bill currently before Parliament.[205] As well as continuing to take forward the National Strategy for Financial Capability, currently undertaken by the FSA , the new body's proposed function will be to enhance:

- the understanding and knowledge of members of the public on financial matters (including the UK financial system); and
- the ability of members of the public to manage their own financial affairs.

The Body will also promote awareness of:

- the benefits of financial planning;
- the financial advantages and disadvantages in relation to the supply of particular kinds of goods and services; and
- the benefits and risks associated with different kinds of financial dealing.[206]

Funding for citizens advice bureaux

117. Citizens Advice Scotland statistics for 2008/09 showed that 360, 836 debt issues were dealt with by Scottish bureaux—a 14% increase on the previous year. This means that on average nearly 1,000 debt issues are dealt with by Scottish bureaux every day of the year.[207] In order to provide a quicker solution for some clients, CAS had introduced a system, in partnership with the financial industry, called "Cash Flow" which provided initial advice to clients on their options. If the clients decided on making certain payments to their creditors, they would go ahead and process the paperwork themselves. However, Vida

203 Information taken from the FSA financial capability website, www.fsa.gov.uk/financial_capability

204 See FSA website, www.moneymadeclear.fsa.gov.uk

205 "Government introduces Financial Services Bill", HM Treasury Press Notice 108/09, 19 November 2009

206 Explanatory Notes to the Financial Services Bill [Bill 6 (2009–10) –EN]

207 Ev 160

Gow of CAS told us that some clients were in such a state of ill health brought on by the stress of the debt situation that they were unable to deal with the arrangements themselves.[208]

118. The 2008 Pre-Budget Report allocated an additional £10 million to Citizens Advice up to March 2010, in order to provide for bureaux opening for extra hours or at new locations, extra staff and telephone lines. Over £1 million was also allocated to Citizens Advice in Scotland.[209] CAS told us that it had been able to funnel this funding straight into front-line local services. We heard in evidence that whilst with the extra funding CAS had been able to meet the demand broadly, there were waiting lists of six or seven weeks for debt advice in some Scottish bureaux. The delays were caused not only by the significant increase in the number of people seeking help, but also because of the increasing complexity of problems people brought in, for example employment, housing and debt problems all rolled into one, which took a great amount of time for CAB staff to unravel.[210]

119. CAS was concerned about the future capacity for CABs to continue to deliver debt services once the extra Government funding ended in March 2010.[211] We asked Lord Myners whether the funding would be extended after March, and in a letter to us dated 22 January he responded:

> The Pre-Budget Report in December 2009 announced a £5 million extension of funding to Citizens Advice to 2010/11, to allow bureaux to help another 300,000 people by retaining their extended opening hours. The Department for Business Innovation and Skills are currently working with Citizens Advice and Citizens Advice Scotland to agree the proportion of this funding that will go to Scotland.[212]

120. **We welcome the news that the Government will provide additional £5m funding to Citizens Advice to allow extended opening hours in 2010–11, a proportional amount of this will be allocated to Scotland. Citizens Advice Bureaux supply a vital service to the general public who have fallen into debt and wish to find a way to get back on an even keel. We recommend that the Government monitors the public's need for advice services and continues to provide extra support for Citizens Advice where it is most needed.**

208 Q 515

209 Ev 166

210 Q 516

211 Q 512

212 Ev 166

4 The reputation of Scotland's financial sector

International perception

121. There has been concern that the difficulties of two of Scotland's major banks, together with the transfer of Dunfermline Building Society to Nationwide, would lead to irreparable damage to the Scotland "brand" of financial services as had happened in Iceland and Ireland. However, CBI Scotland's written evidence to us warned against being too pessimistic. It recognised an adverse effect on Scotland's reputation, but believed that "it would be wrong to suggest that the strong Scottish reputation of other sectors, such as fund management industries and insurance, have been affected to the same extent".[213]

122. Archie Kane of Lloyds Banking Group, like others who gave evidence to us, was optimistic:

> There is little doubt that the impact on the two major banks that were based in Scotland has had a negative impact in terms of jobs, in terms of perception. I would say that the perception that we have within the UK and within Scotland tends to be much more negative than the perception when you go overseas. I go overseas and people do understand that we have had problems, but virtually every jurisdiction overseas has had problems [...] I would advocate that we are realistic, we learn from the mistakes that were made [...] Let us be sensible about it and improve regulation and improve risk management and improve the way that we communicate and make financial products and the risk within financial organisations as transparent and as visible as possible [...] we have to make sure that we accentuate and promote the positive, and we have many, many positive things in Scotland.[214]

David Thorburn of Clydesdale Bank agreed:

> If you travel around the world what you find is in every market in most countries this has been happening and the media attention has been focused on the domestic banks as opposed to what has been happening overseas in Scotland with HBOS or RBS. The financial services sector is much broader than just the banking sector in Scotland. Fund management and insurance has come through this downturn remarkably well. Scotland has an international reputation in those areas which has stood the test of this particular downturn.[215]

However, he expressed concern that the Scottish banking sector might now appear to be less attractive to school and college leavers in Scotland, which might in time affect Scotland's reputation as a provider of a skilled local workforce.[216]

213 Ev 134

214 Q 749

215 Q 669

216 Q 669

123. RBS admitted that financial services companies in Scotland, including RBS, have been affected by the banking crisis, but believed that there was nothing "inherently Scottish" in the difficulties that each company has faced.[217] Adrian Coles from the Building Societies Association added: "I travel to Brussels very frequently, talk to MEPs, the European Commission, other banks, and to the extent that any reputation has been damaged I would say it is the UK's reputation. You rarely hear people talking about the Scottish reputation specifically being damaged".[218]

124. Lord Myners believed that the recapitalisation of RBS and Lloyds, plus the new leadership, would see them in due course regain their standing as admired successful banks, and that the banking sector would eventually rejoin the other successful divisions of Scotland's financial services sector. [219] STUC also believed that any damage to the financial sector was repairable, but warned that the banking sector must be rebuilt to support the wider economy of Scotland.[220]

125. **We conclude that the general view appears to be that irreparable harm has not been done to Scotland's reputation as a centre of excellence for the financial and banking sectors. However, much will depend on whether Scotland's banking sector is able to rebuild trust.**

217 Ev 158

218 Q 673

219 Q 777

220 Ev 136

5 Conclusion

126. The near collapse of RBS and HBOS has had, and continues to have, a wide ranging impact on the banking and financial sectors' workforce in Scotland. In the words of the Group Chief Executive of RBS, only time will tell whether the UK's investment in the banks was worth the "awful lot of schools and hospitals" that the amounts represented.[221]

127. **Banks in receipt of taxpayers' money have made commitments to increase lending to businesses and homeowners, to ensure bank charges are fair and transparent and to meet all reasonable applications for finance from viable businesses. Evidence to this inquiry suggests that banks continue to use unfair and aggressive tactics towards some customers who have fallen into debt. We recommend that the banks work with Citizens Advice Scotland to ensure that these practices are eliminated.**

128. **Whilst we recognise that in the current economic climate banks must lend responsibly, the Federation of Small Businesses, Scotland considers, as do we, that there is a danger that banks have swung too far away from the more generous lending of the past. Viable businesses are being starved of credit as a result. We look forward to the first report from HM Treasury to Parliament which will assess how the banks have met their lending commitments.**

129. **We welcome the optimism of those working in the financial services sector who believe that the reputation of that sector in Scotland has not been permanently damaged by the difficulties experienced by two of Scotland's, and the UK's, largest banks. We are reassured that the quality of the location, the lower costs and the depth and diversity of its labour pool remain attractive to global corporations.**

130. **We make this Report to the House at the end of a Parliament. We recommend that our successor Committee continues to monitor the financial services sector in Scotland to ensure that commitments made by banks, and the actions taken by the UK Government strengthen the banking sector there.**

221 Q 615

Conclusions and recommendations

Impact of the crisis on the financial services workforce

1. It is clear that because of the mismanagement by senior executives of RBS and HBOS, modestly paid staff in the customer-facing retail services of those banks have suffered, and will continue to suffer many months of uncertainty over their future employment. These staff are not to blame for the risks taken by the banks and yet they face the brunt of public's anger at the less than favourable current economic conditions. Whilst it would be unlikely to expect cordial working relationships between unions and banks during this period of restructuring, we are disappointed to hear that the unions consider that they have not been kept fully informed of developments. We would expect banks to make every effort to provide unions with the latest information as soon as it is available and we intend to keep a watching brief on this matter. (Paragraph 46)

2. We conclude that there is cause for concern that the same pressure is being put on front-line staff to sell products, including non-savings products, to customers at pre-recession levels or risk being performance managed out of their jobs. We agree with the unions that there is a danger that customers in debt could be persuaded by bank staff desperate for a sale to take out unsuitable products. We recommend that the regulatory authorities pay close attention to the banks' weighting of their products and performance management schemes in order to ensure that RBS and Lloyds are meeting their commitments to treat their customers fairly. (Paragraph 53)

Bonuses paid to high earners

3. Whilst it is not within the remit of this inquiry or this Committee to make recommendations on suitable remuneration for bank executives, we conclude that it is disappointing that the Scottish banks in receipt of tax payers' money continue to pay large remuneration packages to senior level executives, particularly when the rank and file bank employees on modest incomes are in fear of losing their jobs. (Paragraph 63)

Bank lending

4. We conclude that whilst the banks insist they are open for business, a significant amount of SMEs in Scotland still appear to be struggling to gain access to affordable finance. Whilst we agree that banks must take a more responsible attitude towards lending than they had in the past, banks in receipt of taxpayers' money now have an obligation to explain their decisions on lending to businesses applying for finance. In future we would expect the FSB Scotland to be able to tell us that their members fully understand the reasoning behind the terms on which they have been offered finance. (Paragraph 85)

5. We welcome the evidence we heard which suggests that banks and building societies view repossession as the last resort. (Paragraph 97)

6. Evidence to us suggested that the measures introduced by the Government to promote responsible lending have been welcomed. The Government must continue to monitor the levels of lending, particularly to SMEs to ensure that the pendulum has not swung too far the other way and that banks have become risk averse to businesses. (Paragraph 105)

Fair treatment of customers

7. We conclude that banks continue to use aggressive tactics towards customers who have fallen into debt. We have heard from our own constituents of their terrible stress and anxiety at the repeated, often automated, calls from unsympathetic bank call centres. Whilst we acknowledge that customers must accept responsibility for their spending, we consider that banks, particularly those in receipt of taxpayers' money, have a special obligation to ensure that their staff do not use unduly uncompromising or unfair practices in their communications with their customers. We recommend that the banks use the research undertaken by Citizens Advice Scotland to identify specific areas in which they can improve their communications with customers. (Paragraph 113)

8. We recommend that the regulatory authorities ensure that banks are monitored for bad practices in customer services to ensure that banks do not continue with, or develop further bad practices in these difficult economic times for both businesses and the general public. (Paragraph 114)

9. We welcome the news that the Government will provide additional £5m funding to Citizens Advice to allow extended opening hours in 2010–11, a proportional amount of this will be allocated to Scotland. Citizens Advice Bureaux supply a vital service to the general public who have fallen into debt and wish to find a way to get back on an even keel. We recommend that the Government monitors the public's need for advice services and continues to provide extra support for Citizens Advice where it is most needed. (Paragraph 120)

International perception

10. We conclude that the general view appears to be that irreparable harm has not been done to Scotland's reputation as a centre of excellence for the financial and banking sectors. However, much will depend on whether Scotland's banking sector is able to rebuild trust. (Paragraph 125)

Conclusion

11. Banks in receipt of taxpayers' money have made commitments to increase lending to businesses and homeowners, to ensure bank charges are fair and transparent and to meet all reasonable applications for finance from viable businesses. Evidence to this inquiry suggests that banks continue to use unfair and aggressive tactics towards some customers who have fallen into debt. We recommend that the banks work with Citizens Advice Scotland to ensure that these practices are eliminated. (Paragraph 127)

12. Whilst we recognise that in the current economic climate banks must lend responsibly, the Federation of Small Businesses, Scotland considers, as do we, that there is a danger that banks have swung too far away from the more generous lending of the past. Viable businesses are being starved of credit as a result. We look forward to the first report from HM Treasury to Parliament which will assess how the banks have met their lending commitments. (Paragraph 128)

13. We welcome the optimism of those working in the financial services sector who believe that the reputation of that sector in Scotland has not been permanently damaged by the difficulties experienced by two of Scotland's, and the UK's, largest banks. We are reassured that the quality of the location, the lower costs and the depth and diversity of its labour pool remain attractive to global corporations. (Paragraph 129)

14. We make this Report to the House at the end of a Parliament. We recommend that our successor Committee continues to monitor the financial services sector in Scotland to ensure that commitments made by banks, and the actions taken by the UK Government strengthen the banking sector there. (Paragraph 130)

Annex: note of visit

The Committee visited Dublin on 9–11 November 2009 in connection with its inquiry into Banking in Scotland. During the visit, the Committee met representatives from the following organisations:

- Anglo Irish Bank
- Irish Congress of Trade Unions
- National Asset Management Agency
- IBEC/CBI Joint Business Council
- Department of Finance
- Irish Independent
- Oireachtas Finance Committee and Economic Regulatory Affairs Committee
- Central Bank and Financial Services Authority of Ireland

Formal Minutes

Wednesday 24 February 2010

Members present:

Mr Mohammad Sarwar, in the Chair

Lindsay Roy | Mr Charles Walker

Draft Report (Banking in Scotland), proposed by the Chairman, brought up and read.

Ordered, That the Chairman's draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 130 read and agreed to.

Annex and Summary agreed to.

Resolved, That the Report be the Second Report of the Committee to the House.

Ordered, That the Chairman make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

Written evidence reported and ordered to the House for printing with the Report on 21 October 2009 in the last session of Parliament and 2 December 2009 and 10 February 2010.

[Adjourned till Wednesday 3 March at 2.00 pm

Witnesses

List of written evidence

List of Reports from the Committee during the current Parliament

The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

Session 2009–10

First Report	Work of the Committee in 2008–09	HC 71

Session 2008–09

First Report	Work of the Committee in 2007–08	HC 55
Second Report	Credit Unions in Scotland	HC 218 *(HC 982)*
Third Report	Work of the Equality and Human Rights Commission, Scotland	HC 176 *(HC 140 09-10)*
Fourth Report	Crisis in the Scottish Press Industry	HC 401 *(HC 981)*
Fifth Report	Dunfermline Building Society	HC 548 *(HC 979)*
Sixth Report	Enforcement of the National Minimum Wage in Scotland	HC 380 *(HC 318 09-10)*

Session 2007–08

First Report	Effects of tax increases on the oil industry	HC 35 (*HC 376*)
Second Report	Poverty in Scotland	HC 128 (*HC 525*)
Third Report	Child Poverty in Scotland	HC 277 (*HC 525*)
Fourth Report	Work of the Committee in 2007	HC 278
Fifth Report	Experience of the Scottish Elections	HC 78 (*HC 1098*)
Sixth Report	Employment and Skills for the Defence Industry in Scotland	HC 305 (*HC 830*)

Session 2006–07

First Report	Work of the Committee in 2006	HC 308

Session 2005–06

First Report	Work of the Committee in 2005	HC 836
Second Report	Meeting Scotland's Future Energy Needs: the Westfield Development Centre	HC 1010 (*HC 579*)
Third Report	*Putting Citizens First:* the Report from the Commission on Boundary Differences and Voting Systems	HC 924
Fourth Report	The Sewel Convention: the Westminster perspective	HC 983 (*HC 1634*)