ECONOMY, ENERGY AND TOURISM COMMITTEE

AGENDA

5th Meeting, 2010 (Session 3)

Wednesday 3 February 2010

The Committee will meet at 9.30 am in Committee Room 5.

1. The way forward for Scotland's banking, building society and financial services sector: The Committee will take evidence from—

   Angus Tulloch, and Stuart Paul, Investment Managers;

   and then from—


   Bruce Cartwright, Chairman, Technical Policy Board, The Institute of Chartered Accountants of Scotland, Partner & Head of Recovery Services PricewaterhouseCoopers;

   David Wood, Executive Director, Technical Policy, The Institute of Chartered Accountants of Scotland;

   Iain Coke, Head of Financial Services Faculty, Institute of Chartered Accountants in England and Wales;

   and then from—

   Richard J. Hunter, Group Managing Director for Corporate Ratings Europe, Middle East, Africa and Asia, Fitch Ratings.
The papers for this meeting are as follows—

**Agenda item 1**

Note by the clerk

Note by the clerk
Economy, Energy and Tourism Committee

5th Meeting, 2010 (Session 3), Wednesday, 3 February, 2010

The way forward for Scotland’s banking, building society and financial services sector

Background

1. The Committee received the following three written submissions from today’s second panel of witnesses in response to the Committee’s call for evidence in September 2009:

   - the Institute of Chartered Accountants of Scotland (ICAS);
   - the Institute of Chartered Accountants in England and Wales (ICAEW) Members in Scotland (IMS); and
   - the Association of Chartered Certified Accountants (ACCA).

2. The submissions are attached in the annexe to this paper and Members are invited to take them into account in their deliberations when questioning today’s witness.

Stephen Imrie
Clerk to the Committee
January 2010
SUBMISSION FROM THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SCOTLAND

1. The Business Policy Committee is the Institute’s committee which monitors developments affecting businesses generally and considers legislative and other proposals from bodies such as the DfBIS, the FRC, the FSA and the European Commission. The Committee is broadly based, with members representing different sizes of accountancy practice, industry, the investment community, and the legal profession.

2. As the Institute’s Charter requires, we act in the public interest, and our proactive projects and responses place the general public interest first, notwithstanding our charter requirements to represent our members’ interests.

3. We welcome the opportunity to contribute evidence to the Committee inquiry into the banking, building society and financial services industry, to its assessment of the longer term consequences on the Scottish economy of the global financial crisis on financial institutions, and the desire to identify actions necessary to ensure that Scotland is well prepared to meet the challenges of the economic upturn with Scotland recognised as a leading financial services centre. We have a number of general points below and have answered the specific questions in the consultation where we have evidence to contribute.

General points

4. Our evidence below is based on feedback from our members who are directly employed in financial services; who provide services to the financial services sector and its clients; or provide accountancy and business advice to others in the wider economy. In our view, financial services are a vital part of the Scottish economy in their own right and as an integrated part of the wider economy. Financial services generate significant revenue, support other industries and provide significant employment. It is also beneficial to our national income and our employment prospects to have a full range of different sizes of business, from small and medium sized enterprises (SMEs) to PLCs, in Scotland.

5. Many of our members have noted the changing financial environment in Scotland, which affects their clients and their businesses, with consequences across the economic spectrum:
   - It is harder to raise loan finance;
   - It is also harder to extend existing funding facilities. In addition, the banks are charging substantial sums to extend any existing facilities;
   - Financial covenants are far more rigorously policed by funders, with breaches potentially leading to the withdrawal of funds or increasing costs;
   - Relationships with funders need to be very carefully managed and this can be difficult because many of the relationship managers at banks have either been replaced or no longer have the authority that they previously had;
• There is a need to look beyond loan financing and this requires businesses to seek equity investors and/or public sources of funding. The balance between equity and loan funding may change with less weighting given to bank funding, with consequent reductions in business growth. Arguably, this represents a necessary correction following a period of globally loose pricing and lax control; and
• The impact of the above on SMEs future growth and development needs to be considered.

6. ICAS members also report that funding does remain available for sound businesses: the key to accessing it is a sufficiently strong balance sheet, a tightly run business, and good banking relationships.

7. In order to encourage the economy, including the financial sector, we believe that governments at Holyrood, Westminster, and Brussels, individually and working together, should contribute to economic growth by providing a stable and supportive framework for business, with regulation that focuses on outcomes rather than process. ICAS participates in the Regulatory Review Group, chaired by Professor Russell Griggs, and is supportive of its work. In return, business should be expected to act ethically and with integrity.

Q1. What is your view on the cause, nature and impact of the recent difficulties in the financial sector in Scotland?

8. The recent difficulties in the financial sector in Scotland have wider origins than Scotland alone, as analysed in a number of recent reports. In some Scottish institutions there have also been issues of governance and risk management that allowed financial difficulties to become worse than they need otherwise have been. Specifically, the ABN Amro acquisition by RBS and an aggressive lending programme by HBOS were major contributory factors. The severity of the crisis is also due to factors such as global savings imbalances in search of unrealistically high returns; the dynamics of speculative bubbles (in property, investment banking assets and commodities); and the near universal embrace of "free market fundamentalism" by central banks and governments, and bankers.

9. We would note, however, that we do not think accounting has been a fundamental cause of the financial difficulties. If anything, we think the requirement to mark-to-market certain assets has helped to present the financial problems in a clear and transparent manner, and should enable the UK to regain the confidence of investors – in contrast to the "lost decade" Japan experienced in the 90s when the scale of its problems were hidden.

10. The impact of the difficulties in the financial sector, in broad terms, is to introduce a level of uncertainty, and to reduce confidence, and this should be addressed with a positive, forward looking promotion of Scotland.

11. More specifically, the impact is to reduce available work, to reduce employment, and our members who work directly in financial services or provide accountancy and related services to the financial sector have noted
two trends. First, there is less work, specifically in corporate finance and ‘deal-making’. Some members are now without jobs whilst the recruitment of accountancy trainees is also subject to pressure. Secondly, the nature of the work is changing; there is less high value consultancy, one-off work and that which remains tends to be lower level, compliance work. The calibre of work affects income levels and the quality of staff which it attracts. On the other hand, a reduction in certain areas of work forces businesses to re-examine their sources of income and to be more active and innovative in seeking new sources.

Q2. What evidence do you have on the issue of the availability and the cost of credit and what effect have the initiatives undertaken by the banks, government bodies, regulators and others had?

12. In recent surveys of our members in practice, the majority view has been that loan finance is harder to access, whether it is new finance or extension of existing facilities, and particularly so for SMEs. When it is available, it is more expensive to service. In terms of the initiatives undertaken by banks, government bodies and regulators, the results have been mixed. Those retail banks that are still active are under pressure to strengthen their capital bases at a time when fewer lenders exist. This makes loan finance more expensive than it has been in the recent past, despite the very low base interest rate. We also believe that the Government needs to do more to reconcile the conflict between demands for banks to lend and the demands for banks to strengthen their capital bases.

13. Our members report that the new Enterprise Finance Guarantee loan scheme does not work for early stage companies and is being very sparingly used by almost all the banks. It is particularly difficult to borrow at levels below £2m, as below that level bank officials tend to be applying various rules. Above the level of £2m, more senior managers are involved who are allowed to use their own judgement.

14. Our members have praised the HM Revenue & Customs scheme which allowed businesses to defer taxation, as a pragmatic and helpful step.

Q3. What changes can be expected as part of the ongoing and future restructuring plans in the financial services sector within Scotland?

15. Scotland has a long tradition of financial expertise and a highly skilled professional services community. Financial services businesses should continue to thrive in Scotland but this will depend in part on the banking sector taking up a more innovative and sensible stance with regard to smaller businesses, rather than seeking to rely on larger businesses as a source of trade, since the largest of these are currently bypassing the banks and using bond markets instead.

Q4. How might these changes affect the business and retail banking market in Scotland, access to project finance, a reduction in competition on the ‘high street’ for lending, the plans for the retention of functions
and ‘headquartering’ etc and what can the public sector in Scotland do to ensure the best possible result for Scotland?

16. When Head Office functions move outwith Scotland, there tend to be fewer one-off advisory engagements for accountancy and other professional advisory firms. Although back office functions remain, their demands on accountancy services, for example, will focus on compliance and audit work. This may affect the structure of those professions that support financial services, and skills built up over many years will no longer be required.

17. For the future, it is important that new business is attracted to, and retained in, Scotland. It is also important that new businesses are formed and encouraged to grow. As indicated in the previous paragraph, we would also wish to strongly encourage the banks to retain HQ and senior corporate finance functions in Scotland.

18. We believe that the public sector can and should provide a supportive framework for business. SMEs comprise the vast majority of Scottish enterprises. Because many SMEs lack the resources and scale of large businesses, they depend even more on the enterprise environment to be stable, certain and consistent. This means that changes in access to finance or changes to the taxation regime often have the most damaging effect on these types of businesses. All possible avenues of providing financial support should be considered, such as carefully targeted grants, loans from public authorities, and pension funds and local authorities being encouraged to invest in, or lend to, SMEs because whilst such investors have a primary purpose of prudently maximising returns, there is also a need to encourage a vibrant economy.

19. For many SMEs, a strong local market is vital to their success. Depending on the product or service, this market will involve individual consumers and other businesses. The public sector also has an important role to play. For example, innovative, high-tech health care companies will not develop and grow unless the NHS places orders with them. That means the procurement environment needs to encourage SMEs to tender for provision. We recommend that Governments should engage at EU level to negotiate to allow at least 25% of public sector procurement to be provided by local SMEs. We recognise that larger suppliers may offer economies of scale on particular supplies of services. However, this needs to be weighed against the broader benefits to the local economy if local businesses have an active market place and can flourish.

Q5. What are the current employment levels and skills base in the financial sector in Scotland and how may these change? Additionally, what are the types of jobs that might be expected to be lost as part of any restructuring plans?

20. The type of jobs that may be lost from the financial sector in Scotland as a result of restructuring plans are likely to be twofold:
• Customer facing jobs may be lost with the streamlining and amalgamation of high street banks; and
• More specialist functions within the head offices such as group finance, corporate law, and senior HR may be lost, along with those third party professional services that support head offices. This dilutes the quality of work available and opportunities for career development within Scotland.

Q7. What are your views on the current efforts across the public sector in Scotland to respond to the recent difficulties in the financial sector in Scotland and what, if anything, needs to change in the future as the situation develops?

21. All efforts should be co-ordinated between Scottish and other authorities, including Westminster and Brussels as appropriate, and taking into account developments being considered by the G20 Governments.

Q8. Has Scotland's reputation as a global financial services centre been detrimentally affected by the global crisis and has this been to any greater extent than the problems felt in other financial centres?

22. In our view, in the short term, Scotland’s reputation for prudence and careful stewardship has been dented. The reputation of bank management needs to be actively worked upon and re-instated, although this may take some time. However, it should not be forgotten that other financial organisations remain well capitalized and continue to perform relatively well given the current economic climate.

Q9. How should Scotland differentiate itself and promote itself as a financial services centre in the future and what steps are being taken by our competitors in this respect?

23. Leadership in promoting the financial services sector and supporting services should come from the industry itself to re-establish its reputation for quality, innovation, integrity and value for money, backed up by solid performance.

24. Partnerships between the Scottish and UK Governments, Scottish agencies, and Scottish Financial Enterprise should be further developed, to actively market the sector as part of a highly qualified and expert economic structure. Differentiation for Scotland will come from factors such as:

• A relatively small and closely connected business sector that can provide a range of professional services including finance, legal and accountancy advice;
• A highly educated workforce;
• An attractive lifestyle for employees;
• One of the strongest centres for fund management in Europe; and
• A well developed 'angel' finance network which operates effectively to help provide finance for SMEs.
Q10. How can we ensure that the Scottish financial sector continues to retain a global perspective and does not retreat into a purely localised lending regime?

25 As noted under question 9 differentiation and promotion are important. Additionally, Scotland’s financial sector consists of some very large businesses which access global markets in order to deliver results for investors and policyholders as they strive to deliver shareholder return in the current economic climate. It would go against the interests of many of the businesses in the sector to retrench. The marketing noted in response to Question 9 needs to target not just Scotland, but also the rest of the UK, EU and globally.

I hope these comments are of assistance to your inquiry. Please do not hesitate to contact me should you wish to discuss any of the above points further or if you would like us to provide any verbal evidence to the Committee.

David D Wood  
Executive Director, Technical Policy  
The Institute of Chartered Accountants of Scotland  
10 September 2009
1. The ICAEW Members in Scotland (IMS) group is pleased to respond to the Economy, Energy and Tourism Committee’s call for written evidence on the inquiry into the way forward for Scotland’s banking, building society and financial services sector.

2. We hope that these comments help to inform the inquiry. We are happy to provide any further input or to discuss any of the points raised in more detail.

INTRODUCTION

3. The ICAEW Members in Scotland (IMS) welcomes the opportunity to submit written evidence to the inquiry into the way forward for Scotland’s banking, building society and financial services sector.

4. IMS is the dedicated Scottish branch of the Institute of Chartered Accountants in England & Wales (ICAEW) serving over 1300 members across the private and public sectors in Scotland. IMS represents the views of ICAEW members who work in Scotland for Scottish and international organisations and disseminates information from ICAEW to its members in Scotland.

5. ICAEW operates under a Royal Charter, working in the public interest. The regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the ICAEW provides leadership and practical support to over 132,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The ICAEW is a founding member of the Global Accounting Alliance with over 700,000 members worldwide.

6. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The ICAEW ensures these skills are constantly developed, recognised and valued.

OUR RESPONSE TO SPECIFIC INQUIRY QUESTIONS

Q1. What is your view on the cause, nature and impact of the recent difficulties in the financial sector in Scotland?

7. In the ICAEW’s submission to the House of Commons Treasury Committee hearing into Accountancy and the Banking Crisis (November 2008), we stated:

8. “Broadly, our understanding is that the current financial crisis originated in the combination of vast sub-prime lending in the US, falling American property
values that grew out of a period of unprecedented availability of cheap credit, and increases in US interest rates. The collapse in confidence was fuelled by doubt about the viability of many financial institutions holding significant assets that depended directly or indirectly on property lending. Other institutions, which have lent to or invested in firms more directly exposed, have in turn faced losses. Contagion spread throughout a globalised financial system, a process significantly exacerbated by the collapse of Lehman Brothers.

9. “Concerns about the relative strength of the capital base of a number of leading financial institutions led to reductions in the liquidity available to those institutions, which cumulatively resulted in a sharp contraction of funds available to the banking system generally and the ability of banks to provide credit to the ‘real economy’. Banks curtailed lending in order to restore capital ratios to prudent levels. As the excessive willingness of lenders to lend was arguably a leading cause of current problems, it is unsurprising that they are now much more cautious, indeed perhaps over-cautious.

10. “The contraction of credit is currently precipitating a significant decline in economic activity, which reinforces the risks to systemic financial stability.”

11. Whilst the outcome is yet to be shaken out, it appears that the Scottish banks have suffered heavily in a retrenching of operations, leaving significant numbers formerly employed in financial services in Scotland out of work.

12. **Appendix 1** shows the relation between business confidence in the UK (tracked in the ICAEW quarterly Business Confidence Monitor) and key points in the ‘credit crunch’.

**Q2. What evidence do you have on the issue of the availability and the cost of credit and what effect have the initiatives undertaken by the banks, government bodies, regulators and others had?**

13. In July 2009 the ICAEW published a report on SME Access to Finance in the UK ([www.icaew.com/smefinance](http://www.icaew.com/smefinance)). The key findings included:

- SMEs are finding it harder to access finance, with companies in the construction, property and retail sectors worst affected;
- There appear to be inconsistencies between and even within banks in lending practices, although the general trend is for a far more cautious approach to lending;
- Conflicting pressures are affecting demand for credit: difficult trading conditions heighten the need to borrow while many SMEs decide not to approach their banks for credit for fear of rejection or increased bank charges;
- Relationships between SMEs and lenders are becoming strained and damaged;
- Being judged a ‘going concern’ – which can cause audit issues - is a major worry for SMEs.
Some SME advisors feel the cost of borrowing is too high, while others feel it is merely now more realistic;

There appears to be low awareness among SMEs of government-supported ‘health checks’ and schemes to help access lending. Schemes are thought to be not very accessible and not working together as a whole;

The majority of respondents expected the supply of credit to increase within the next three to 12 months. None expected it to fall;

Reducing company taxes and forcing banks to lend to viable SMEs on reasonable terms are the most popular suggestions for ways in which the government can help, followed by a more proportionate approach to small business regulation.

14. Anecdotal evidence from talking to members in business in many sectors in Scotland has revealed that finance is generally available, albeit at a higher price than previously. One member, running an on-line retail business expressed great frustration that his bank could not differentiate the cash flow needs of his growing business from the travails of a suffering business and he was seeking finance from a non-banking source to fuel his growth.

Q3. What changes can be expected as part of the ongoing and future restructuring plans in the financial services sector within Scotland?

15. As mentioned in our response to question 2, above, ICAEW research shows that the supply of credit to SMEs is expected to increase.

16. However, initial developments are likely to see risk being priced highly and banks’ volume of lending unlikely to be at levels seen recently. To sustain business the pricing will need to be absorbed by businesses which have perhaps got used to borrowing being in plentiful supply at low cost. Once the “new” pricing regime is accepted it is likely that the volume will return as business needs finance to carry on trading.

Q4. How might these changes affect the business and retail banking market in Scotland, access to project finance, a reduction in competition on the ‘high street’ for lending, the plans for the retention of functions and ‘headquartering’ etc and what can the public sector in Scotland do to ensure the best possible result for Scotland?

17. The competition will continue, although the mergers of financial institutions have reduced the number of names on the High Street. The market has been changing as on-line offers have sought to bypass physical presence and face to face transactions.

18. The public sector can support both options by ensuring premises are available on High Streets for banks and other lending organisations and by ensuring training and the very different accommodation is available for those wishing to establish call centre operations to make Scotland the destination of choice.
19. The slides in Appendix 2 show forecasts from the ICAEW’s research, comparing the banking finance and insurance sectors with UK averages, showing that turnover, gross profit and sales are expected to bounce back in the next 12 months, although total salaries (including bonuses) and headcounts are still forecast to decrease.

Q5. What are the current employment levels and skills base in the financial sector in Scotland and how may these change? Additionally, what are the types of jobs that might be expected to be lost as part of any restructuring plans?

20. Our research (see Appendix 2) shows that employment levels are forecast to drop slightly in the next 12 months in the banking, finance and insurance sector.

21. The financial services sector in Scotland employs people across the full range of skill levels. Having been well established for many years the skill sets have been nurtured and developed as the sector has grown. The skill levels are likely to remain as the sector will rebuild employment levels and seek to do this where skilled employees reside.

22. It is for the financial services companies themselves to restructure their businesses, but in the short-term it would be reasonable to assume that jobs would be expected to be lost in ‘front office’, processing and sales positions, if those functions are most at risk. Likewise as more emphasis is place on risk functions, financial regulations and compliance, we may say employment growth in those areas.

Q6. How are employment levels in the financial sector calculated at present, under what definitions and how do these relate to ONS figures? What changes are required to make employment figures more meaningful and comparable with other financial centres?

23. This is a question better addressed by ONS, however HMRC of necessity has information on employees in Financial Services businesses, whilst that might include job titles, that is not specific enough on role and skill levels utilised.

Q7. What are your views on the current efforts across the public sector in Scotland to respond to the recent difficulties in the financial sector in Scotland and what, if anything, needs to change in the future as the situation develops?

24. One issue in particular which the ICAEW has highlighted in the past is the need for cross border engagement over Financial Services regulation:

25. A commitment to high quality, principles-based regulation will help restore confidence in the financial services industry. The UK has a leadership role to play in supporting transparent and comparable international reporting standards. An incoming administration should also review the reporting
structures and information flows regarding systemic risk in the financial system.

• **Commit to evidence-based, well-resourced, globally coordinated and principles-based financial services regulation:** When developed in cooperation and consultation with international regulatory authorities, proportionate and effective UK regulation will help to enhance confidence in financial markets. To tackle the complexity of financial services regulation, UK regulators need staff with the necessary skills and experience. A principles-based approach to regulation, sufficiently flexible to be relevant to a fast-paced business environment and with an emphasis on ethical codes and practices, should be the bedrock of reform.

• **Support transparent and global financial reporting:** Transparent and reliable financial reporting is integral to building market confidence. In a global marketplace financial reporting standards should be set at the global level, through due process and within the appropriate accountability and governance frameworks. However, in times of crisis there can be huge pressures to limit transparent reporting, for fear of the commercial repercussions, and to withdraw from global standards in order to appease certain national industries. These pressures must be resisted at a political level. Where national or international authorities wish to dampen the effects of the business cycle, this should be introduced through regulatory requirements for information or for holding capital – not through adapting the financial statements. Transparent reporting during the 2007/8 financial crisis is recognised to have highlighted problems sooner than would otherwise have been the case and enabled faster economic recovery. Despite the fact that transparency can be commercially and politically sensitive, the UK must continue its commitment to both transparent and global financial reporting and support greater investment choice and comparability across countries, across industry sectors and across companies.

• **Improve awareness of systemic risk issues across the financial services industry:** One of the major causes of the 2007/8 financial crisis was a collective failure to appreciate systemic risk. There now needs to be a collective spirit of partnership to improve awareness of systemic risk, marked by strong channels of communication and transparency of relevant information. The responsibilities for collecting information and reporting on systemic risk need to be clearly assigned in the UK and new tools are needed to manage this risk at global and local levels. As political attention focuses on financial services regulation and corporate governance reform, the spotlight should also fall on the need to:
  - improve the transparency of bank boards’ ‘risk appetite’;
  - increase the clarity about how risk management information flows to bank boards;
work to improve the systems of cross-border regulatory cooperation, highlighting practical cross-border difficulties posed by legal and other constraints;

- promote better dialogue on systemic risk, including regulatory authorities providing periodic risk outlook briefings for relevant non-executive directors and strengthening the relationship between regulators and bank auditors.

Q8. Has Scotland’s reputation as a global financial services centre been detrimentally affected by the global crisis and has this been to any greater extent than the problems felt in other financial centres?

26. The Scottish banks by retaining “Scotland” so clearly in their title have resulted in brand damage to the nation, even although any fault may be elsewhere. However as the situation has evolved that damage has faded and the problem is seen as a global financial crisis.

Q9. How should Scotland differentiate itself and promote itself as a financial services centre in the future and what steps are being taken by our competitors in this respect?

27. Scotland needs to reaffirm its place as a centre of prudent business decisions, where careful planning and sustainable approaches are paramount.

28. Moving forward, the Scottish financial services sector will have to ensure it has the skill pool and depth of skills available to restore confidence in its abilities.

Q10. How can we ensure that the Scottish financial sector continues to retain a global perspective and does not retreat into a purely localised lending regime?

29. The businesses operating in the Financial Services sector remaining in Scotland still include international players. These businesses will overcome the fall-out from the current situation and continue to make their mark globally. The test will be to marry prudence with the bigger markets. Business is displaying an understanding that this philosophy is not “old-fashioned” but rather has a leading place in financing the businesses of tomorrow.

30. As stated in question 9 above, moving forward, the Scottish financial services sector will have to ensure it has the skill pool and depth of skills available to restore confidence in its abilities.

31. Also see our comments about cross-border engagement over Financial Services regulation, under question 7 above.

Q11. Why are "new" banks choosing to establish themselves in Scotland, what is it that is particularly attractive and how can we build on this and attract additional investment into Scotland?
32. The attraction to new banks is the availability of experienced workforce and the heritage of the financial services sector in Scotland. It may be that they too recognise a need to return to former values for a sustainable financial market in the future.

33. In view of this attraction it is crucial to promote the skills of the financial services workforce in Scotland and to continue to invest in the retention and development of these skills within the workforce.

Resources:

www.icaew.com/index.cfm/route/167437/icaew_ga/Members/Member_initiatives/Business_confidence_monitor/Q3_2009_Scotland/pdf

www.icaew.com/smefinance

www.icaew.com/g20
Q. Overall, how would you describe your confidence in the economic prospects facing your organisation over the next 12 months, compared to the previous 12 months?

ICAEW
Appendix 2

Average % change Q3 2009 ……

- … over last 12 months
- … expected next 12 months

UK AVERAGE

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Last 12 Months</th>
<th>Next 12 Months</th>
</tr>
</thead>
<tbody>
<tr>
<td>Turnover</td>
<td>-2.4</td>
<td>2.5</td>
</tr>
<tr>
<td>Gross profits</td>
<td>-3.2</td>
<td>2.3</td>
</tr>
<tr>
<td>Sales</td>
<td>-2.6</td>
<td>2.3</td>
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Banking, finance & insurance

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Last 12 Months</th>
<th>Next 12 Months</th>
</tr>
</thead>
<tbody>
<tr>
<td>Turnover</td>
<td>-5.0</td>
<td>2.7</td>
</tr>
<tr>
<td>Gross profits</td>
<td>-5.5</td>
<td>3.5</td>
</tr>
<tr>
<td>Sales</td>
<td>-6.2</td>
<td>3.4</td>
</tr>
</tbody>
</table>

Q. Thinking about the last 12 months, how have each of the following changed for your organisation?
Q. Thinking about the coming 12 months, what will be the probable change for your organisation for each of …..

Base: UK - 1000, Banking Finance & Insurance - 105
Average % change Q3 2009 ……

… over last 12 months

UK AVERAGE

Banking, finance & insurance

- Average Basic Salary
  -0.8
  -0.7

- Average Total Salary
  -0.6

- Number of Employees
  -2.9

- Average Basic Salary
  0.7
  0.4

- Average Total Salary
  -2.9
  0.6

- Number of Employees
  -4.1
  -0.1

Q. Thinking about the last 12 months, how have each of the following changed for your organisation?

Q. Thinking about the coming 12 months, what will be the probable change for your organisation for each of …..

Base: UK - 1000, Banking Finance & Insurance - 105

ICAEW
Average % change Q3 2009 ......

- over last 12 months  
- expected next 12 months

UK AVERAGE

Banking, finance & insurance

Q. Thinking about the last 12 months, how have each of the following changed for your organisation?
Q. Thinking about the coming 12 months, what will be the probable change for your organisation for each of ....

Base: UK - 1000, Banking Finance & Insurance - 105

Keith Proudfoot
Regional Director
ICAEW Northern Region & Scotland

11 September 2009
SUBMISSION FROM THE ASSOCIATION OF CHARtered CERTIFIED ACCOUNTANTS (ACCA) SCOTLAND

1. While there is general agreement on what has happened, there is far less agreement on why it occurred and it seems that there is still much to learn about market liquidity.

2. A strong, robust financial sector is required by Scotland to help make it a more prosperous country with the people of Scotland reaping the benefits. The government has the opportunity to support this and other business sectors by engaging with representative bodies, the sector and regulator. The government should aim to create an environment where business is supported. It should also lobby the regulator and promote Scotland as a country of choice for the financial services sector.

Q1. What is your view on the cause, nature and impact of the recent difficulties in the financial sector in Scotland?

3. The recent publication *Gross Domestic Product for Scotland, Quarter 1 2009* [http://www.scotland.gov.uk/Publications/2009/07/GDP2009Q1](http://www.scotland.gov.uk/Publications/2009/07/GDP2009Q1) highlighted statistically the dramatic fall in output we all knew would occur. In the first quarter of 2009 financial services output in Scotland fell by 4.4 per cent. The statistics published also show the high added value the sector provides and its decline in 2008 and 2009. However, the impact of the crisis has spread to all areas of the economy.

4. In the ACCA papers *Climbing out of the Credit Crunch* [http://www.accaglobal.com/pdfs/credit_crunch.pdf](http://www.accaglobal.com/pdfs/credit_crunch.pdf) and *The Future of Financial Regulation* [http://www.accaglobal.com/economy/](http://www.accaglobal.com/economy/) ACCA highlighted the root causes of the credit crunch, suggested standards of business conduct and laid down a number of principles which should be reflected in the future design and administration of regulatory systems in the financial services and other business sectors. The following extract from *Climbing out of the Credit Crunch* highlights the causes:

Key factors

5. ACCA believes that excessive short-termism, coupled with a lack of accountability both within financial institutions and between management and shareholders, is at the heart of the problem. This has meant:

- Failure of institutions to appreciate and manage the inter-connection between the risks inherent in their business activities and management and remuneration incentives

- Remuneration structures/bonuses of banks being characterised by excessive short-termism. This neither supports prudent risk management nor works in owners’ long-term interests

- risk management departments in banks which did not have sufficient influence, status or power and
• Weaknesses in reporting on risk and financial transactions.

Further contributory factors were:

• Over-complexity of financial products and lack of management understanding of the associated risks – including the fact that, currently, there is no genuine market for certain asset-backed securities

• Over-dependence on debt and an assumption of a continuing low cost of capital environment

• Scale of issuance of securities and the interconnectedness of financial institutions, especially between retail and investment banking

• Human weaknesses: a failure to appreciate the influence of cultural and motivational factors such as rigidity of thinking, lack of desire to change. An attitude of ‘it is not my problem’, inappropriate vision/drivers and, perhaps most importantly, human greed

• Lack of training to enable management to understand underlying business models, leading to poor managerial supervision

• Lack of rigorous challenge by non-executive directors possibly caused by poor understanding of the complexities of the business and

• Bad habits and complacency after a prolonged bull market.

6. ACCA believes that underlying much of the credit crunch has been a fundamental failure in corporate governance. While the financial institutions involved may have been in compliance with local requirements and codes, they have ignored the key point – good corporate governance is about boards directing and controlling the organisations so they operate in their shareholders’ interests. Boards should be answerable to company owners, to account properly for their stewardship and to ensure both sound internal control and the ethical health of the organisations. The use of overly-complex financial products, which thwarted effective supervisory control, and the unethical advancement, at the point of sale, of loans to people with little realistic hope of repaying them shows a lack of basic corporate governance.

Q2. What evidence do you have on the issue of the availability and the cost of credit and what effect have the initiatives undertaken by the banks, government bodies, regulators and others had?

7. Support for the global market is only achieved by a co-ordinated global approach. No one country alone could achieve market stability. Countries have introduced individual schemes to support business or sectors. For example, the car scrapping scheme in the UK has been well received by the industry. The success of the general business schemes to help improve the credit flow have been mixed. Many of the schemes have had poor take-up,
are confusing for businesses or simply can't be effectively used by established or growing businesses. This is frustrating for both lender and borrower.

8. However, the support that does work and is being used is the Business Payment Support Service run by HMRC. Where a business can show it needs time to pay it can in advance defer business taxes including VAT, PAYE and NIC, CIS, SA or CT.

9. So far 141,000 businesses have participated in the scheme deferring £2.5bn in taxes. The most popular deferral is VAT which accounts for 42% of the take-up. This is equal to 1.5% of the Government’s total predicted income from VAT.

10. Support to the sector and all businesses should continue to be evaluated and where necessary enhanced. The Scottish government, working with representative bodies and the sector, has a key duty to monitor and comment on the success of the support made available to all businesses.

Q3. What changes can be expected as part of the ongoing and future restructuring plans in the financial services sector within Scotland?

11. The Scottish government can influence how regulation is applied to the sector by engaging with representative bodies, the global and local financial services industry and the regulator. The following bullet points below are from ACCA’s publication *The Future of Financial Regulation*. They highlight the key points to be considered before the option of increased regulation is proposed. They are:

- The apparent recent failures of the 'light touch' approach to regulation should not lead authorities to conclude automatically that a heavy-handed approach would be the appropriate solution. While it is understandable that governments wish to be seen taking decisive action in response to crises, it must be recognised that regulatory failures have occurred under both types of approach. The crisis in the banking sector occurred not because of a lack of regulation – the sector has in fact been subject to a very extensive rulebook – but because of the ineffectiveness of that regulation. Regardless of the conceptual approach adopted, what is essential is that regulatory authorities are effective in carrying out their various functions, in particular the supervision of regulated entities, and succeed in their regulatory objectives.

- The element of competition is key to effective regulation. The greater the size and complexity of a business, the more difficult it becomes not only to regulate but to manage. The phenomenon we have seen of banks that are 'too big to fail' must stimulate governments and regulators to promote healthy competition in the market place, both for the benefit of the wider economy and for the achievement of more effective regulation. The benefits of competition should also be borne in mind in determining the extent to which international alignment of regulatory practices is
appropriate. Moves initiated by the recent G20 meeting of world leaders to encourage the sharing of knowledge and best practice on a global or regional basis are welcome but this should not necessarily mean that uniform requirements and procedures must be adopted by all regulators regardless of local market circumstances.

- The framework of regulation adopted in any country must have a clear purpose that is understood by regulators and regulated entities alike. In the banking sector, the protection of depositors should be seen as the principal objective in the context of encouraging public confidence in the system. There must be mechanisms in place for ensuring effective communication between the two sides, and regulators should endeavour to generate a positive commitment on the part of regulated entities to the achievement of the objectives of the process. Regulatory authorities must also have sufficient resources to ensure that the market knowledge and skills of their staff are, and remain, adequate for the purpose of exercising the effective supervision of complex business structures and evolving business practices.

- Regulatory authorities should take reasonable steps to ensure that regulated entities possess the skills and experience, at all levels of the business, necessary for them to comply with regulatory requirements and protect the interests of their stakeholders. Authorities should also encourage the adoption, in financial institutions, of ethics-based corporate cultures which have the aim of ensuring that they act transparently and with a real appreciation of the long-term interests of their stakeholders.

- Regulators should adopt a systemic approach to the safeguarding of stakeholder interests, ensuring all relevant factors are addressed effectively. In the financial sector, this means, among other things, taking wider macro-economic factors fully into account. This will complement more effective monitoring of the capital and leverage ratios of individual institutions. The activities of specialised entities which are currently outside the regulatory net should be reviewed and, where appropriate, brought within its scope.

- The accountancy profession must consider ways of making the processes of financial reporting and auditing more useful to stakeholders. Enhancing the quality of reporting on risk should be central in this context. But it is neither necessary nor desirable to redesign accounting standards so as to meet the specific information requirements of regulators. Information which regulatory authorities need for their purposes should be obtained separately, via dedicated prudential rules.

- The crisis has highlighted a number of serious weaknesses in corporate governance and risk management practices, even among companies which followed the express requirements of official guidance on these matters, and these failures need to be addressed. There needs to be a specific review of the role of non-executive directors, and in particular consideration of whether new measures could be taken to enhance their effectiveness in exercising supervision of the executive in large and complex institutions. Companies can also do much more to engage with
their shareholders and to encourage them to play an active but responsible part in the governance process.

Q4. How might these changes affect the business and retail banking market in Scotland, access to project finance, a reduction in competition on the ‘high street’ for lending, the plans for the retention of functions and ‘headquartering’ etc and what can the public sector in Scotland do to ensure the best possible result for Scotland?

12. The Scottish government must ensure that both local and global business continue to recognise Scotland as a country of choice. This will be achieved by creating an environment where business can succeed and ensuring the message of stability is promoted globally to the financial sector.

Q5, Q6 and Q7 not included in this reply.

Q8. Has Scotland’s reputation as a global financial services centre been detrimentally affected by the global crisis and has this been to any greater extent than the problems felt in other financial centres?

13. It is a financial services issue that has had an impact on every global financial services sector. Businesses will continue to take decisions that will sustain them in the future. The Scottish government should continue to work with all financial services organisations to provide and facilitate appropriate support.

Q9. How should Scotland differentiate itself and promote itself as a financial services centre in the future and what steps are being taken by our competitors in this respect?

14. See 11

Q10. How can we ensure that the Scottish financial sector continues to retain a global perspective and does not retreat into a purely localised lending regime?

15. See 11

Q11. Why are "new" banks choosing to establish themselves in Scotland, what is it that is particularly attractive and how can we build on this and attract additional investment into Scotland?

16. The government policy to attract “new” banks should apply to all financial services organisations. Government policy should support all business by creating a stable business environment. However, financial sector organisations will determine the best approach for overseas lending and investment based on their respective experience and knowledge.

17. Scotland has years of experience in financial services so there is a wealth of knowledge and experience that can be capitalised upon by new entrants to
the Scottish market. Businesses choose to establish themselves in countries that help them trade successfully. Scotland is recognised as a prudent and stable financial place of business. The workforce is educated and financial literacy is good. The Government must ensure both local and global business continue to recognise Scotland as a country of choice. This will be achieved by creating the environment business requires and ensuring the message of stability is promoted globally to the financial sector.

ACCA Scotland
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