

ECONOMY, ENERGY AND FAIR WORK COMMITTEE: SUBMISSION ON THE SCOTTISH NATIONAL INVESTMENT BANK

0. OUR VISION

In answering the questions set by the Committee it will help to begin by briefly outlining Common Weal's vision for a Scottish National Investment Bank. We published the two reports which led to the creation of the Bank (one on the scope and principles, one on the relevant technical considerations) and have integrated our vision for the Bank into many of our policy papers (for example on economic development, renewable energy, housing and public infrastructure). It is from this body of work that our vision derives.

Common Weal sees the Scottish National Investment Bank as a long-term structural intervention into the Scottish economy. Its aim is to drive investment into the Scottish economy in ways which prioritise the public good and in particular in ways that support the long-term development of Scottish enterprises and 'anchors' them in the Scottish economy. It should also support the development of world-

class public infrastructure, housing and energy infrastructure for Scotland. In time Common Weal believes the Bank should also support and coordinate a Scotland-wide system of local banking on a mutual or publicly-owned basis. This would both address the problem of declining access to banking services in many parts of Scotland and act as the primary financial support structure for small businesses (most small enterprises do not borrow money but rather rely on long-term relationships with local banking services).

We envisage the Bank as a source of finance which is tailored to public-good outcomes, but the bank must operate on full cost recovery basis as a commercial bank would (but without extracting private profit). It must be mission-driven not only to ensure the public good aspect but also to comply with European Union competition laws. But it should not be the job of the Bank to seek to achieve public-good outcomes alone. Rather it should work with a range of 'intermediate institutions' which

would stimulate demand and make strategic interventions, providing finance packages tailored to need in discussion with customers and stakeholders. Common Weal has already outlined proposals for a Scottish National Infrastructure Company (an adapted form of the Scottish Futures Trust which would let the Bank lead on funding packages and instead focus on best practice in infrastructure design and project management), a Scottish National Energy Company and Energy Development Agency (based on the Danish model and driving investment into a coordinated energy system on a strategically-planned basis) and a revised enterprise support network orientated around the bank. We will publish further work on other intermediate institutions such as a National Housing Company and a body to oversee a Scottish Green New Deal.

In this model the bank would accept any applications for lending or equity investment. These might come directly from enterprises or projects or by negotiating appropriate lending packages with intermediate institutions which would market those to relevant customers. Any applications the Bank receives would then be assessed against a series of current 'missions' which would help to give a weighting to different applications based on an assessment of how well they align with the missions (and, in the initial stages at least, the available capital). For example, if two very similar applications were submitted, the Bank would prioritise the one which had a better profile on, for example, gender equality or efficient energy use - but it does not mean that both projects couldn't be funded so long as both were judged not to be acting against the Bank's missions. It is for the Bank to provide finance to applications which meet its criteria; it is for the intermediate institutions to stimulate demand and take a strategic approach to specific aspects of the economy.

A fully-operating Bank would be able to raise capital from sources other than government (for example by attracting pension fund investment) and would be able to leverage that capital when lending or investing (we believe that a three-to-one capital liquidity ratio is sensible and cautious, enabling the bank to lend £3 for every £1 it holds in capitalisation). To be able to attract this kind

of investment the Bank should aim to develop a balanced 'loan book'. Lending to medium-sized enterprises can be comparatively high-risk. This can easily be off-set if the Bank ensures significant exposure to low-risk lending. There is very substantial scope for this in Scotland because of under-investment in public rental housing and energy infrastructure and also because of the need to replace current funding models for public infrastructure. If the Bank has a portfolio exposure which is 70 per cent housing, energy and public infrastructure (all of which is very low-risk) it will position it well to be able to take a greater risk in the 30 per cent of its lending which is to businesses, social enterprises and so on. This will make the Bank a very attractive investment opportunity for investors looking for reliable long-term returns (such as pension funds). There is every reason to believe that the Bank could be capable of meeting as much demand as emerges through this form of capitalisation and leverage - we believe total investments made could quickly reach the scale of tens of billions of pounds, contingent on demand.

To ensure that a long-term approach is taken in the running of the Bank we have proposed that there should be a balanced governance structure. The Bank must be a corporate entity which has an independent Board which is wholly responsible for the Bank's operation. It will be wholly owned by government and government may set broad strategic goals but government will not be able to instruct the Bank directly on its business practices. Governments can at times take a short-term approach as a result of electoral cycles and if left to financial administrators alone it would be easy for the public-good mission of the bank to get lost over time. To address both of these issues we proposed that the professionals who run the bank should receive advice from a second source to act as a balance to the role of government. We therefore proposed an advisory body which would be a tripartite stakeholder body representing customers (private and social enterprises), stakeholders (such as local authorities or housing associations) and representatives of public-good concerns (such as trade unions, environmental organisations and equalities groups). The Advisory Group would provide its advice directly to the Board of the Bank.

To reach this vision will take some time. The major barrier is that there will need to be negotiations with both the UK Treasury and Bank of England (and potentially the European Union) to gain dispensations to make all this possible. Effectively the Scottish National Investment Bank needs to be treated in exactly the same way as RBS (which is majority publicly owned but the liabilities of which are not counted against public sector debt and it is exempt from 'co-investment' restrictions). Common Weal has confidence in the team which is setting the Bank up. Their view is that we will be in a stronger position to engage in these negotiations if the Bank is first able to demonstrate demand. We agree with this position and so are content with the broad thrust of the legislation and the approach being taken since it enables the first phase and does not restrict a second phase. However, we would like to see an ambitious development programme set for the Bank which would see it seeking to begin the above negotiations within two or three years of operation, enabling the Bank to approach the vision set out above within perhaps five or six years.

1. COMPANY MODEL

What are the advantages or otherwise in establishing the Bank as a public limited company?

The Bank must operate independently of government and on a basis similar to if it was a commercial entity (though without profit extraction). Common Weal is therefore content that the PLC model is appropriate.

2. CHARACTERISTICS

What your view are the fundamental characteristics of a national investment bank?

These have been set out in the vision outlined above.

3. LEVEL OF CAPITAL

Is the level of capital proposed sufficient for the Bank to deliver its desired impact? Please expand.

No - but it should be sufficient to get through the first phase of the development of the Bank. The truly transformative opportunities arise when the Bank can attract non-governmental investment and can leverage its capital. The quicker this can be achieved the greater the impact of the Bank.

4. RUNNING COSTS

What is your view on the proposed costs in the and day-to-day running of the Bank?

We have confidence in the team setting up the Bank and while we are not privy to the details of the business plan we are inclined to accept that proper investment is necessary to create firm foundations for the Bank. We are not thinking in terms of a return on initial investment in a five-year timescale but in a 50-year timescale. In that context a running cost which has a higher ratio to investments made in the early years is acceptable if it creates the basis for a more secure long-term future. However, we would naturally wish to see the best possible value for money for any public finances and would want costs such as salaries to be appropriate but kept under proper control.

5. GOVERNANCE

What governance arrangements ought to be in place?

We have outlined our proposed model above. We are content with the proposals in the Bill, subject to the Advisory Group reporting directly to the Bank's Board rather than having its advice

interpreted and mediated through the Scottish Government. It should not be possible for any future management of the Bank to 'dispose of' the Advisory Group because of the risk of drift away from its mission-driven purpose. There is a case for exploring whether the strategic direction of the Bank might be set jointly by the Scottish Government and the Advisory Group rather than by the Scottish Government alone.

6. MARKET READINESS

How can we ensure the market is ready for the investment opportunities the Bank can offer?

We can't - but there are actions we can take. First a strong message needs to be sent out that this Bank exists and operates differently from other banks. It is important to grow confidence among potential enterprises which have been put off approaching existing banks. It will help if substantial public communication includes examples of the kinds of projects that might wish to come forward; we need to stimulate the imaginations and confidence levels of potential projects. The more substantial interventions to increase market demand should be made by separate intermediary institutions as outlined above and this should begin quickly, particularly in public infrastructure, housing and energy. However, it should also be borne in mind that there is a very strong argument that lack of market demand is evidence for the long-term need for the Bank and not the opposite - if there is insufficient demand for investment in Scotland that does not suggest the current structures of finance are operating optimally. This must not be seen as a short-term intervention.

7. ETHICAL CONSIDERATIONS

What ethical and equalities considerations do you think should inform the Bank's ethos and decision making?

As outlined above, we think the Bank should consider any applications for finance which are made and that the ethical and equalities considerations should be picked up by assessing applications against a range of missions and weighting those applications against how well they meet a mission. Only applications which are judged to work actively against these missions should be excluded from consideration. The Bank should report annually on its lending strategies and the criteria it has used to assess applications.

8. STRATEGIC DIRECTION

It is proposed that the Scottish Government will set the strategic direction of the Bank but the body itself decide on its investment approach. What is your view on this "mission-led" approach?

We would add that the Scottish Government and the Advisory Group should set and advise on the strategic direction of the Bank. But the Board of the Bank must be wholly and solely responsible for the successful operation of the Bank.

9. OTHER

Is there any other aspect of the Bill you wish to address? Please elaborate.

As it is currently worded the Bill does not exclude the ability to lend to public bodies (for example to provide funding for school building which does not include an element of private profit) - but it does appear to skew the vision quite heavily in the direction of it being an 'SME' bank. This will set up false expectations; the vast majority of small enterprises do not borrow in any form other than overdraft and their needs are better met through reliable retail banking. It is more likely it will focus on business phases such as large-scale start-ups or medium-sized enterprises scaling up, diversifying or targeting new markets. If the

Bank misses taking an absolutely central role in investing in areas like energy infrastructure, housing, public infrastructure, the next generation of transport infrastructure and so on it will simply fail to have a fraction of the impact it ought to have. That means that the Bank must be set up with an eye to developing financial relationships with public bodies and local authorities as well. We accept that the limited capitalisation of the Bank means that it probably won't prioritise projects like public infrastructure in the short term but since this legislation is for an institution we hope will exist and develop for 50 years and more it is important that it does not restrict future development. For example, much has already been made of the role of the Bank in a potential Green New Deal in Scotland, but that is simply not feasible if the Bank cannot lend to the public sector. We believe the language of the Bill would benefit from emphasising a bit more the role of the Bank as an investment institution for all of Scotland and de-emphasise a bit the focus on purely SME lending.

FOR FURTHER READING

The bank

Banking for the Common Good: Laying the foundations of safe, sustainable, stakeholder banking in Scotland

<https://www.commonweal.scot/policy-library/banking-common-good-laying-foundations-safe-sustainable-stakeholder-banking>

Blueprint for a Scottish National Investment Bank

<https://www.commonweal.scot/policy-library/blueprint-scottish-national-investment-bank>

Scottish National Investment Bank: Submission to Consultation

<https://www.commonweal.scot/policy-library/scottish-national-investment-bank-submission-consultation>

Investment opportunities

An Investment-Led Economic Development Framework For An Independent Scotland

<https://www.commonweal.scot/policy-library/investment-led-economic-development-framework-independent-scotland>

Powering Our Ambitions

<https://www.commonweal.scot/policy-library/powering-our-ambitions>

Renewables Scotland 2030: A discussion paper on how to transform Scotland's energy sector by 2030

<https://www.commonweal.scot/policy-library/renewables-scotland-2030-discussion-paper-how-transform-scotlands-energy-sector>

Building Scotland's future now: A new approach to financing public investment

<https://www.commonweal.scot/policy-library/building-scotlands-future-now-new-approach-financing-public-investment>

Housekeeping Scotland: Discussion paper outlining a new agenda for housing

<https://www.commonweal.scot/policy-library/housekeeping-scotland-discussion-paper-outlining-new-agenda-housing>

Towards an industrial policy for Scotland: A discussion of principles and approaches

<https://www.commonweal.scot/policy-library/towards-industrial-policy-scotland-discussion-principles-and-approaches>