FINANCIAL AND BUSINESS SERVICES KEY SECTOR REPORT

Scottish Government
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Financial and Business Services Key Sector Report

Contents

OVERVIEW

This paper sets out a current description of Scotland's Financial and Business Services Key Sector, identifies challenges faced as well as potential opportunities and then describes the public sector interactions with the Key Sector and assesses the effectiveness of those to date.

As can be seen, from the *Public Sector Interaction* section [page 9] at this stage the majority of public sector activity has concentrated on the financial services element of the Key Sector in Scotland. The *Assessment of the Effectiveness of Interactions* section [page 13] includes details of future actions to be taken to address the public sector interaction with the business services industry.

It is also important to set out the context in which this assessment of the Key Sector has been made and the following paragraphs provide a brief overview of recent events.

Context: Current Issues

The global financial services industry is in a period of major change and the outcome of these changes present both challenges and opportunities for the industry here in Scotland.

Background

Following intensification of the market turbulence that began in autumn 2007, September and October 2008 saw a re-escalation of the international financial crisis, against a backdrop of an increasingly pronounced economic slowdown, a housing market downturn, and in the banking sector, weakened balance sheets. Rapidly deteriorating investor confidence led to bankruptcies, unexpected private-sector takeovers of financial institutions, and government interventions to restore stability to markets and contain overspill to the real economy.

On 8 October 2008, the UK Government announced a package of interventions to shore up the banking sector. It would guarantee up to £250bn of new inter-institution lending to reduce counterparty risk and build confidence in the interbank lending market. The Bank of England's Special Liquidity Scheme (initially launched in April 2008), whereby banks may swap high quality mortgage-backed assets and other securities for Treasury Gilts, was expanded. The Scheme closed for new business on 30 January 2009, although existing swaps of asset-backed securities from UK Treasury Bills may stay in place for 3 years. At least £50bn in capital was made available to purchase shares in UK banks, whereby balance sheets could be shored up in exchange for partial nationalisation and accompanying conditions. On 13 October 2008, the UK Government announced capital injections of up to £37bn, which would potentially leave it owning 60% of RBS, and 43.5% of the proposed Lloyds TSB/HBOS merged group. Following the UK announcement, part-nationalisation through capital injection was widely adopted in Europe and the US.

On 19 January 2009 the UK Government then announced a new package of measures designed to both support the industry and to increase lending by banks. This included the Asset Protection Scheme aimed at addressing losses from "toxic" assets held by financial institutions. On 3 November 2009, RBS announced agreement on terms for entry to the Asset Protection Scheme and as a result, HM Treasury's ordinary shareholding remains at 70.3% (voting share cap of 75%) while the economic interest (the value of the government investment as a proportion of the value of all investment) rises to 84.4%. Lloyds Banking Group will not participate in the Scheme and will instead raise additional private sector capital - HM Treasury shareholdings will therefore remain at 43.5%.

Scotland

The impact on the structure of Scotland's financial services industry has been felt mainly in the banking sector with the merger of HBOS and Lloyds TSB (becoming the new Lloyds Banking Group) aided by the UK Government waiving competition rules in the public interest, leaving concerns about the long term competitiveness of the sector in Scotland. On 30 March 2009, Dunfermline Building Society's wholesale and retail deposits, branches, head office and originated residential mortgages (other than social housing and related deposits) were transferred to the Nationwide Building Society under the terms of the Banking Act 2009. Subsequently, Nationwide successfully bid for Dunfermline's social housing portfolio which had been held in a bridge bank wholly owned by the Bank of England.

However, it will be some time before we know what the long-term impacts will be on the size, shape and focus of Scotland's financial and business services sector going forward and how this will affect performance. It is not yet fully apparent how the divestments required under EU State Aid provisions (see Page 7) may impact on the restructuring proposals (and any potential associated job losses) previously announced by RBS and Lloyds Banking Group (see Page 6). In the medium term, the shape of the banking sector in Scotland could look quite different - we have already seen some "new entrants" like Tesco Bank and Virgin in Scotland and the need for divestments provides an opportunity to increase the players in Scotland in both banking and insurance. The manner in which such "new players" deliver their products to customers may be quite different from current models. In the long term, UK Financial Investments Ltd (UKFI) will be looking to ensure that the UK Government's interests in banks are returned to the private sector - and at a rate of return which protects the taxpayer as far as possible. How this is undertaken e.g. in respect of RBS may well have an impact on the banking sector in Scotland.

The following section illustrates the significant growth and contribution of the sector in recent years.

Description of Scope and Performance of the Sector

The financial and business services[1] key sector comprises a diverse range of activities that can be broadly categorised into the following sub-sectors:

Financial Services	**Business Services**
• banking • life and pensions • general insurance • asset management • financial intermediation	• legal activities • accountancy, auditing and tax • management consultancy • architectural and engineering activities • technical testing and analysis • advertising • recruitment • security activities • industrial cleaning

Financial and Business Services

- In 2008, financial and business services accounted for just under 359,000 employee jobs, or 15% of all employment in Scotland[2].
- The latest Scottish Quarterly GDP Index[3] (for 2009 Q3) shows that GDP in the sector is around 72% higher in real terms than at the start of 1998.
- It is also a major export sector, accounting for over a fifth of Scotland's total exports (rest of UK and rest of world, 2008)[4].

[1] Statistical Definitions: Financial services: SIC 65-67. Business Services: SIC 74.

[2] 2008 employment figures are the most recent annual figures currently available from the Annual Business Inquiry. Annual employment data for 2009 is due to be released in December 2010.

[3] The Scottish Quarterly GDP index measures output at basic prices. Gross value added, or GVA, is another term for GDP measured at basic prices).

[4] Exports are derived from Scotland's Global Connections Survey (GCS), published in March 2009. Exports to the rest of UK are currently classified as "in development" and therefore should be treated with caution. The figures for key sectors are derived by aggregating estimates based at a low standard industrial classification (SIC) level. The GCS is not designed to collect data at this level of accuracy, therefore these results should be treated as indicative.

- In 2009, 96% of registered enterprises in the sector were small (0-49 employees), only 2% were large (250+ employees); 97% of registered enterprises were Scottish owned, 2% UK owned, with 1% under foreign ownership.
- Almost half of all employment in both financial and business services is based in Glasgow and Edinburgh, with Aberdeen the next largest base for financial and business services employment in Scotland.

Table 1: Key Statistics on Financial and Business Services

		Employment (2008)	GVA (2007)	GVA per employee (2007)	Turnover (2007)	Exports to RoW (2008)	Exports to RUK (2008)
Financial and Business Services		358,900				£1.3bn	£12.4bn
	% of Scotland	15%				6%	29%
Financial Services		95,500				£0.6bn	£10.5bn
	% of F&BS	27%		n/a		46%	85%
	% of Scotland	4%		n/a		3%	25%
Business Services		263,400	£10.1b	£41,555	£17.2b	£0.7b	£1.9bn
	% of F&BS	73%		n/a		54%	15%
	% of Scotland	11%		n/a		3%	4%

Notes:
1. Shaded cells denote that financial data is not available for Financial Services, as the Annual Business Inquiry (ABI/2) does not cover the sector.
2. GVA is another term for GDP at basic prices.
3. Exports are derived from Scotland's Global Connections Survey (GCS), published in March 2009. Exports to the rest of UK are currently classified as "in development" and therefore should be treated with caution. The figures for key sectors are derived by aggregating estimates based at a low standard industrial classification (SIC) level. The GCS is not designed to collect data at this level of accuracy, therefore these results should be treated as indicative.
4. Employment data is sourced from the Annual Business Inquiry and is based on SIC 2003 classification of industries.

Financial Services

- Scotland is internationally recognised as the most important UK financial centre outside London and the South East, with a breadth of services including global custody, asset servicing, banking, investment management, corporate finance, general / life assurance and pensions.
- Although Scotland's banking sector, like banks across the globe, has experienced significant difficulties this does not reflect the industry-wide picture and recent announcements of expansion and investment plans by financial services companies have buoyed prospects for the future. These have included over 800 new jobs for Glasgow announced by Tesco Bank, which is in addition to the 200 new posts already announced for Edinburgh and the 500 new jobs being created in Glasgow by Esure. This has been supported by significant assistance from Scottish Enterprise (SE) and Scottish Development International (SDI).
- Employment stood at 95,500 in 2008[5], which represents 4% of the total Scottish workforce, as well as 9% of all financial services employment in Great Britain. Almost two thirds of jobs in financial services are based in Edinburgh and Glasgow, but there are also significant financial services companies in Aberdeen, Perth and Dundee.

[5] 2008 employment figures are the most recent annual figures currently available from the Annual Business Inquiry. Annual employment data for 2009 is due to be released in December 2010.

- Employment in financial services covers employment across a range of sub-sectors, further detail about which is given in Annex 1. The share of employment in financial services across GB varies across the sub-sectors. Life and Pensions in particular stands out in Scotland, with over a fifth of all employment in that sector across GB in 2008.
- In 2009, small businesses (0-49 employees) accounted for 87% of enterprises, but only 6.5% of employment in the sector. Conversely, medium (50-249 employees) and large (250+ employees) enterprises accounted for just 13% of businesses, but 93.5% of employment.
- Scotland has a long standing legacy of indigenous financial services institutions sitting alongside a range of international firms. In 2009, 86% of registered businesses were Scottish, accounting for 56% of employment. Just 6% of enterprises were under foreign ownership, but accounted for 20% of employment.
- The latest Scottish Quarterly GDP Index for Scotland shows that in 2009 Q3, output in Scotland's financial services industry, was 69% higher in real terms than at the start of 1998. Output in the Scottish economy as a whole was 18% greater in real terms, while output in UK financial services as a whole was 74% greater.

Business Services

- Output in Scotland's business services, as measured by the Scottish Quarterly GDP Index, was 75% higher in real terms in 2009 Q3 than at the start of 1998, compared to 55% across UK business services as a whole.
- The latest Annual Business Inquiry data show that business services contributed just under £10.1 billion in GVA to the Scottish economy in 2007. The legal and accounting activities sub-sector makes the largest contribution (£2.8 billion), followed by architectural, engineering and related technical consulting (£2.7 billion) and recruitment (£1.8 billion).
- The sector accounted for employment of 263,400 in 2008[6], around 11% of all employment in Scotland. Just over half of all business services jobs were based in Glasgow (24%), Edinburgh (16%) and Aberdeen (13%).
- The sector exports a substantial amount both to the rest of the UK and the rest of the world, with total export earnings increasing by a total of 41% over 2002-2008 in real terms[7]. The latest available data show that in 2008, business services exports to the rest of the UK stood at just under £1.9 billion, while exports to the rest of the world were around £0.7 billion.
- In 2009, small businesses (0-49 employees) accounted for 97% of enterprises but only 36% of employment in the sector. Conversely, large businesses (250+ employees) made up just 1% of enterprises but accounted for 47% of employment in the sector.
- Indigenous firms are prevalent in the Scottish business services sector, accounting for 97% of enterprises and 68% of employment in 2009. In contrast, just 1% of firms were under foreign ownership, accounting for 15% of employment in the sector.

Rationale for Key Sector Status

The ***Government Economic Strategy*** (GES) identifies that Scotland's businesses are the primary driver of sustainable economic growth, and that Scotland's national competitiveness depends critically on the competitiveness of our individual businesses. Some sectors and firms offer the potential for high levels of growth, and the opportunity to strengthen Scotland's areas of international comparative advantage, through achieving critical mass and boosting productivity. Sectors have the potential to make a significant contribution to increasing Scotland's growth where:

[6] 2008 employment figures are the most recent annual figures currently available from the Annual Business Inquiry. Annual employment data for 2009 is due to be released in December 2010.
[7] HM Treasury GDP deflators used to convert nominal export data to 2008 prices.

- Scotland has distinctive capabilities and businesses with the potential to be internationally successful in areas of global demand;
- they currently account for a significant part of the Scottish economy and reflect the contribution of all areas of Scotland; and
- government intervention can make a significant difference to future success by facilitating or accelerating development in areas where the market alone cannot deliver the best outcome.

Financial Services – notwithstanding the current turmoil in international financial markets, Section 1 demonstrated the key role of financial services through:

- Scotland's long standing international reputation for success in financial services;
- the crucial role that the sector plays in the Scottish economy; and
- the fact that the economic performance of financial services has been strong for a prolonged period.

Business Services – business services is also a crucial sector for Scotland, having grown rapidly in recent years to comprise a large and diverse range of professional services. There is scope for Scotland to build on this success and better leverage the linkages that exist with the financial services industry, particularly in areas such as legal services and accountancy. Not only are these sub-sectors likely to be key customers of each other, a combined approach will potentially present Scotland's capabilities across the range of professional services and demonstrate critical mass on an international scale.

Targeted government intervention – alongside economy wide action to create a supportive business environment, and developing the underlying sources of competitiveness strength in Scotland - on areas of importance to both sectors notably in skills, education and infrastructure can drive future success where the market alone cannot deliver the best outcome. Moreover, the nature of the current environment highlights still further the need for supportive government policy in both the short and long term.

CHALLENGES AND OPPORTUNITIES

Challenges

We find ourselves in a time of unprecedented change in the global financial services industry. The interventions by Governments throughout the world have initiated changes to the structure and governance of financial institutions. Prior to the developments in the last few years, these changes would have been unthinkable, not only in the USA where there are significant fears concerning "public ownership" of financial institutions, but also in the UK where the part-nationalisation of some banks has led, for example, to the UK Government having to set up a new organisation – (UKFI) which will manage the Government's shareholdings in banks which have been involved in the recapitalisation plan. It is being run on a commercial basis at arms length from the Government. It is also responsible for disposing of the UK Government's investments in a manner consistent with HM Treasury's stated aims that it should not be a permanent investor, maximising sustainable value for the taxpayer and taking account of risk.

Interventions in the financial services sector

The significant interventions undertaken by governments across the world, while stabilising and supporting the global financial system will also have implications more widely and over the long term. Considering the interventions that have taken place in the UK (as outlined in the paragraph above and on page 1) there are impacts likely to be felt in a number of ways:

- The impact on public sector budgets;
- The impact on the wider economy;
- The impact on savers, shareholders and other customers (e.g. mortgagees); and

- The long term effects of borrowing by the UK Government on the economy as a whole.

At Budget 2009 the UK Government published provisional estimates of the cost of the various financial interventions suggesting that they may ultimately incur a loss of between £20 and £50 billion (1.5% - 3.5% of GDP) as a result of their financial market interventions. When these unrealised losses are included in the public finances, HM Treasury forecast that UK net debt will peak at 79% of GDP in the UK in 2013-14 compared to 76.2% when they are excluded. However, such forecasts are subject to a wide margin of error. Recent estimates by the IMF suggest that the final cost of the UK Government's financial market interventions could be around £130 billion (9.1% of GDP).

It should be noted however, that the vast majority of the overall recent deterioration in the UK public finances has stemmed not from the direct interventions to support the financial services sector but from the general slowdown in the UK economy and accompanying fall in taxation receipts.

Like the UK and many other advanced economies, the Scottish economy entered recession as the impact of the international financial crisis spilled over into the real economy. Although initially concentrated in the sectors linked to the housing market (e.g. construction, estate agents, legal services), all sectors within the Scottish economy have been affected by the downturn.

Weaker activity resulted in a marked deterioration in conditions in the Scottish labour market, with unemployment rising sharply since the start of 2009 (up to 7.4% in Sept-Nov 2009, from 5.2% in the same quarter a year previous).

Much time and energy has been spent, across the world, in considering what actions need to be taken to ensure that future difficulties in the financial services industry cannot spread and impact on other sectors of the wider economy. Many believe that actions cannot be taken in isolation at a national level and institutions such as the UK Government, EU and G20 are currently seeking agreement on the way forward. It is difficult therefore to accurately gauge at this point what this might mean for Scotland's financial services industry.

Shortly after the announcement proposing the Lloyds TSB takeover of HBOS the Office of Fair Trading in its report of 24 October 2008 (published on 31 October 2008) outlined concerns that it may lead to significant lessening of competition. If it does, this could be of serious concern to Scottish depositors (both retail and business) and have wider implications for the structure of the financial services industry in Scotland over time. However, in the statement from the European Commission announcing the restructuring of several banks across Europe (the UK plans are outlined in more detail below), the EU Competition Commissioner noted that the proposed divestments in the UK retail market were 'substantial and will improve competition in the long run'.

Changing shape of the financial services industry

In light of discussions with the European Commission and institutions' own efforts to cut costs and rebuild balance sheets, restructuring of financial institutions is ongoing.

Restructuring announced by RBS and Lloyds so far include:

- **RBS Restructuring**: aims to save £2.5 billion per year; the bank to be separated into two arms - with riskier assets and operations grouped together. Overseas business to be cut back, with its operations to be reduced or sold in 36 of the 54 countries it works in. It will restructure as a premier financial institution anchored in the UK and it will "centre on the UK with tighter, more focused, global operations".

- **Lloyds Banking Group**: the restructure required to combine two large organisations will result in job losses as posts are combined - in its shareholder circular in advance of the acquisition of HBOS, the Lloyds TSB Board stated it believed it will deliver total annual pre-tax cost savings greater than £1.5 billion by the end of 2011. Announcements by the Group to date have involved changes to both Group Operations and Insurance Division. The group has also announced it will retain the Scottish Widows brand and concentrate pension and investment activity in Scotland - indicating the underlying strength of Scotland's reputation in financial services.

Banks which have received assistance from the UK Government are also subject to decisions around EC State Aid:

- The European Commission (EC) recognises that state intervention has been necessary to secure the future of aided banks and allow businesses continued access to finance.

- Support schemes across all Member States have been deemed compatible with State Aid regulations subject to certain conditions, namely that measures are:

  - well targeted and proportionate;
  - time limited to address acute crises without creating long term reliability on state funds; and
  - coupled with adequate private sector contributions by way of adequate remuneration for state support.

- It is the view of the EC that aid measures must be followed by restructuring of aided institutions and the financial sector as a whole, to preclude the need for further bailouts. Further, wider regulatory reform and cultural change in financial institutions should be pursued with a view to returning the banks to self reliance whilst ensuring long term sustainability and protecting the interests of taxpayers and non-aided competitors.

In keeping with the above, a number of banks across Europe (including KBC in Belgium, and ING in the Netherlands) have been in discussions with the European Commission on their restructuring plans. As outlined on 3 November, the plan for RBS involves the sale of its insurance arm, its branch network in England and Wales, NatWest branches in Scotland and its Williams and Glynn brand. The Lloyds Banking Group divestment plan involves the sale of at least 600 branches across the UK, with the associated accounts and mortgages.

EC approval for the Lloyds divestment plans was announced on 18 November 2009, followed on 14 December 2009 of approval for the RBS plans.

While these plans provide both challenges and opportunities for Scotland's economy and for the financial services industry in Scotland, until more detailed plans are set out for each divestment strategy its difficult to arrive at clear implications for the sector in Scotland.

The Scottish Government's main and immediate concern is to ensure there is not a loss of key functions and employment in Scotland either directly or indirectly. The Scottish Government has therefore established the Finance Sector Jobs Taskforce to co-ordinate efforts across Scotland to ensure maximum levels of employment are retained within the financial services industry, focusing on understanding the needs of the industry as it adjusts to the future structures which will emerge as a result of the current climate. There are also concerns about maintaining Scotland as a perceived attractive business location for financial services companies notably around the reputational effect of the HBOS and RBS problems.

To summarise, the challenges in the financial services industry relate to the current international financial crisis and the recession. These challenges are both immediate and potentially longer term, for example, the restructuring plans agreed by the EC for banks as a condition of receipt of State Aid, could take four years to realise.

- For individual financial services companies there is concern about the impact on the profitability and value of their individual organisations.

- The capital injections provided to banks by the UK Government are intended to stabilise the sector, though it will be some time before the full implications of the crisis become clear.
- In the medium term, there are likely to be regulatory changes to the financial services sector and the EU and international dimensions of these changes may mean that financial services companies will be dealing with their requirements for some time and they could impact on the structure of some companies.
- The impact on the wider economy is still an ongoing concern. Although conditions in financial markets have stabilised, credit availability still remains constrained and is a major risk to the both the timing and the scale of the global economic recovery.
- Employment in financial services – and indeed business services – have come under strain, although to date the job losses in the financial services industry have not been as significant as first thought and have been mitigated to a great extent by recent job creation announcements. It remains to be seen whether the quality of jobs gained and lost are of equal volume or whether the mass of higher value added jobs in the financial services industry has been negatively impacted. Restructuring at both RBS and Lloyds Banking Group may still produce significant job losses in the industry.
- In the medium and longer term, significant job losses in financial services will reduce the skills base of its available workforce and constrain the sector's capacity to grow.
- There are significant risks to the reputation of Scotland's banking sector given high profile government intervention in RBS and HBOS.

Opportunities

As well as being a significant challenge to the financial and business services sectors, the current financial situation also presents opportunities in the medium and long term. The main Bank of England interest rate now stands at 0.5% and the significant help provided to banks with taxpayer funds was made on the condition that credit availability would return to 2007 levels. The trading environment is of course still very challenging and credit availability still remains constrained to both businesses and individuals. However the IMF has stated that the unprecedented interventions by Governments across the global economy have helped reduce the risk of a systemic collapse in financial markets. Monetary and fiscal measures introduced by governments have helped mitigate the scale of the downturn through stimulating demand.

Businesses, in both the financial and business services sectors, could have an opportunity to exploit this easing of market conditions so that once some form of normality resumes, the sector in Scotland is well placed to not only recover but to grow and expand. The ability to do so is dependent upon meeting those challenges above particularly those related to reputation, the skills base and capacity. This also creates opportunities for new inward investment. Scotland has always positioned itself as a low risk, lower cost location where companies can take advantage of the existing infrastructure and assistance available to achieve operational cost efficiencies and saving. Where firms are being driven to reduce costs, this gives Scotland an advantage for any company wishing to expand and grow its business here.

For business services specifically, there are further opportunities for the sector in terms of the support services that can be provided to other growth sectors, such as life sciences and creative industries for example (particularly for patent/management consultancy for example). Furthermore, the proposed Scottish legislation allowing alternative business structures within the legal profession may well provide opportunity for growth.

Meeting Challenges and Identifying Opportunities

What is becoming clear is that we need to be able to identify all of the challenges and opportunities which may present themselves. Co-ordination of this across the economy might prove difficult, but the Financial Services Advisory Board (FiSAB) has an opportunity to take the lead. FiSAB has most recently decided to refresh its membership, to better represent the different sub sectors in the industry operating in Scotland. It also decided to invite representatives from the

Bank of England and the Financial Services Authority (FSA) to attend meetings when appropriate. The Financial Services Implementation Group (FiSIG) has undertaken a "scenario planning", facilitated by experts from the Universities of St Andrews and Edinburgh to identify a range of possible future scenarios and actions which might mitigate risks and capitalise on opportunities created by these scenarios. These actions were, in turn, sense checked against current plans and high level objectives. It was concluded that the actions continue to fit the current pillar structure of the *Strategy for the Financial Services Industry in Scotland* and that the *Strategy* and the work of FiSAB is increasingly important.

Public Sector Interaction with the Key Sector

While the sector as described in the GES encompasses business services, the vast majority of the work undertaken to date by the Scottish Government (SG) and public sector partners is in the financial services arena, with the Financial Services Advisory Board (FiSAB), set up in 2005, representing a key collaboration between the SG and the financial services industry.

Strategic Level

Financial Services Advisory Board (FiSAB)

- FISAB is a collaboration between SG, SE, SDI, Universities Scotland, Scottish Financial Enterprise (SFE); Unite the union and the financial services industry. It is chaired by the First Minister and representatives from HM Treasury have observer status.
- The Board delivers the ***Strategy for the Financial Services Industry in Scotland***.
  - *The Strategy for the Financial Services Industry in Scotland*[8] sets out the vision for "An innovative, competitive and thriving international financial services industry in Scotland, underpinned by world-class infrastructure and universally recognised as a leader on the global stage". In particular, the key strategic aim is to "exploit market opportunities through innovative products and services". This industry-led strategy recognises three areas for action under the following headings:
    - **People and Skills:** skills and labour market development, raising the appeal of the industry as a career choice, financial education in schools;
    - **Profile:** further developing the proposition for the industry in Scotland, raising the profile of Scotland as an international FS centre, attract value added foreign direct investment (FDI), engage meaningfully with key stakeholders such as FSA, EU, UK T&I and HM Treasury;
    - **Infrastructure:** transport and connectivity, communications, city collaboration, support for innovation, university collaboration and supply chain development.
- During 2008, the FiSAB partnership delivered the Global Financial Services Week in Scotland which aimed to cement Scotland's position as a leading centre of the international financial services industry. The week included the inaugural global financial services conference which took place in Edinburgh.

Financial Services Implementation Group (FiSIG)

- FISIG is a working group which mirrors the membership of FiSAB. It is tasked with ensuring the implementation of the strategy.
- The Financial Services Team in SG focuses on working with FiSAB and provides secretariat support for both FiSAB and FiSIG.
- SE works closely with the leading industry body, SFE, to promote the sector within Scotland, UK and internationally. SE also link with colleagues in UK Trade & Investment's Financial Services team.

Scottish Enterprise's International Advisory Board

[8] A copy of the strategy can be found at http://www.scotland.gov.uk/Publications/2005/03/20865/54747

- In August 2002 SE established the International Advisory Board (IAB) where members are invited to join in recognition of their experience, positions of international prominence and influence in their respective industries – including financial and business services – and their willingness to contribute to Scotland's wealth creation agenda.
- Chaired by Crawford Gillis, Chairman of SE, the IAB complements the role of the SE Board by contributing international business advice and market development perspective to Scotland's economic development drive.
- The IAB has met bi-annually since inception. At these meetings members provide advice on strategy, guidance on key landmark projects and support to Scottish companies with significant international potential.

Business Experts and Law Forum (BELF)

- The BELF, established to see what could be done to enable and encourage businesses, so far as possible, to choose Scotland as the seat of their business and legal activities; to look to Scottish lawyers for their advice; and to look to the Scottish courts as their dispute resolution forum of choice reported in November 2008.
- Its report identified as priorities:
    - Reforms to the courts and arbitration which would create opportunities to attract dispute resolution business - and reduce costs and risk for business in Scotland.
    - A communications strategy which promotes Scottish legal services alongside other business services as part of a highly qualified and expert economic infrastructure which actively assists business.

Operational Level

Regional Selective Assistance (RSA)

- SE provides support to firms across a wide range of sectors through its RSA grant scheme.
- Over the last five financial years, £38 million of RSA support has been provided to some of Scotland's most prominent financial and business services companies.

SMART: SCOTLAND

- SMART: SCOTLAND provides financial support to firms to support Research and Development (R&D) projects.
- Over the last few years, SMART: SCOTLAND has funded early-stage R&D projects aimed at providing technology to assist financial services firms.

Since 1 October 2009, SE has been responsible for the administration of the RSA and SMART: SCOTLAND grant schemes. Both of these schemes were formerly administered by the SG.

Finance Sector Jobs Taskforce

- Established following agreement in the Scottish Parliament, and reporting through the FiSAB structure, the Taskforce is chaired by SE and both SG and SDI are members. Collective understanding of the range of public sector interventions available and different partnerships across all three organisations has enabled a small, focussed team to be set up including representatives from SDS and the Scottish Funding Council. The Taskforce also has industry representation in the form of Scottish Financial Enterprise and Unite the union as well as representatives of local authorities through CoSLA.

Scottish Enterprise (SE)

- Following the re-focus of SE, activities have concentrated on boosting enterprise, innovation and investment across its key sectors industries.
- The main areas of operation within financial services are outlined below:

<u>Enterprise</u>

- supporting the development of growing businesses through account management;
- working with Scottish businesses to help them take advantage of opportunities to be part of the supply-chain of the major financial institutions (with a focus on technology suppliers;
- working with businesses to assist their expansion into international markets; and
- helping to attract senior staff in areas of recruitment difficulty through the work of Talent Scotland.

<u>Innovation</u>

- facilitating industry-university collaboration in areas such as informatics; and
- increasing awareness of support for innovation in the sector and across the supply chain.

<u>Investment</u>

- raising the profile of the financial services sector in Scotland to attract high value FDI and working with existing investors to retain and grow their operations;
- utilising previous physical investment in Glasgow's International Financial Services District to help attract new businesses to Scotland and accommodate the growth of existing businesses;
- internationalisation of Scottish financial services companies
- working with financial services businesses to increase the supply of risk capital to growth businesses through initiatives such as the Scottish Co-investment Fund; and
- working with the industry to articulate its need for enhanced connectivity, including links between Glasgow and Edinburgh and international flights. In addition, SG officials maintain engagement with colleagues in Transport Scotland on the evolving Strategic Transport Review.

Highlands and Islands Enterprise (HIE)

- The financial and business services sector is a relatively new area of focus for HIE, however one which is important to the economy of the area, therefore HIE's focus is on providing the most appropriate methods of support to help the sector continue to grow in the future.
- HIE has a clear emphasis on the business services element of the sector in the Highlands and Islands. This includes activities within the scope of the Financial and Business Services sectoral description set out on page 2, including e.g. Management Consulting, Security Services and Advertising in relation to business services and banking and insurance in relation to financial services. In addition, HIE has identified opportunities for growth in developing the broader business services sector including the contact centre sector, homeworking business models, the green data centre market and further growth of knowledge-intensive services such as the ICT supply chain.
- Since the 1990s HIE has however invested significantly in infrastructure that is crucial to financial and business services, and this was key to securing a number of inward investment projects for the Highlands and Islands which continue to enjoy success in the area.
- HIE is currently developing a clear sectoral strategy congruent with the national vision for financial and business services. Good relationships are being established with SG, SE, SDI and SDS colleagues; with HIE actively involved in community of practice and training activities for sector teams.

Scottish Development International (SDI)

- SDI was formed in 2001 to attract FDI to Scotland. SDI has a specific Financial Services Team, which also has membership of FiSIG.
- Funded entirely by the SG, SDI is a joint venture between the SG and SE and brings together the resources and capability of both organisations to deliver support for companies investing in Scotland and for domestic companies looking to internationalise.
- SDI has staff in 21 offices throughout the world including the UK, mainland Europe, North America and Asia.

Skills Development Scotland (SDS)

- In April 2008, the new skills body, SDS, took over responsibility for addressing skills issues by actively promoting financial services as a career choice and by working with the industry to attract a wider range of people. This role had previously been fulfilled by SE and Careers Scotland. SDS has now implemented new structures to work towards achieving the SG's purpose and has appointed a specific Financial and Business Services sector Manager.
- SDS is in the process of developing its offer to employers and the Sector Manager is making connections to ensure a strong voice for the sector in the shaping of SDS' products. Successful legacy products are continuing such as "Stock Market Challenge", and awareness raising programme which will engage S3 pupils in 125 schools.
- On 31 August 2009 The First Minister unveiled plans for 460 new financial and business services apprenticeships across Scotland. These places are being backed by £549,000 funding, as part of the SG's skill support package, ScotAction, which is being taken forward by SDS. 450 of the new Modern Apprenticeships have been allocated with 345 of them available to adults in response to industry demand.

Financial Services Skills Council (FSSC)

- The FSSC is an independent, employer-led organisation that provides strategic leadership for education, training and skills development for financial services, accountancy and finance across the UK.
- Like all Sector Skills Councils (SSCs), they have a lead role in vocational qualifications and in collating and communicating sectoral labour market data as well as raising employer engagement, demand and investment and considering collective measures.
- All SSCs are licensed by the Secretary of State for Innovation, Education and Skills, in consultation with Ministers in Scotland, Wales and Northern Ireland and on the recommendation of the UK Commission for Employment and Skills.
- The FSSC has not succeeded in gaining relicensing at this point and is currently undergoing a management review. Liaison in ongoing with SDS and the Skills Gateway Initiative as part of this.

Skills Gateway

- In May 2008 the First Minister announced an industry-led (CBI Scotland inspired) initiative which is developing a proposal to deliver a Skills Gateway for financial services.
- The First Minister has received the proposal for the Skills Gateway and the SDS Financial and Business Services Manager is working with key partners to take forward actions on roles and responsibilities, governance structures and delivery. Consultations have taken place with key industry figures and the FSSC team with a view to streamlining structures. The outcome of the re-licensing process will be pivotal.

Regulation and Compliance Issues

Financial Services

Regulation of the financial services industry in Scotland is a reserved matter at both UK and EU level. FiSAB can act to provide a collective "Scottish Voice" on Regulatory matters, though to date this has tended to be done by individual companies or separate groups (e.g. the Committee of Scottish Clearing Banks) working with the SG. The global nature of the financial crisis has led to international calls for changes to regulation and governance of financial institutions and for international co-operation on these matters. Both the EU and the G20 are currently considering a number of issues and the UK Government is expected to announce its plans for the industry following delivery of commissioned reports on regulation and governance issues.

The legal system

The key area of regulation which is primarily devolved is the court and legal system. The Civil Courts Review led by Lord Gill reported on 30 September 2009. While there has been welcome progress in areas such as the development of commercial courts, the report identified significant problems of delay and expense which can impact negatively on Scottish business. The Government will now work with the courts to restructure and reorder the work of the courts, enabling businesses to litigate in a more efficient legal system. This will be done alongside existing initiatives to promote cost-effective solutions to disputes outwith the court system, such as the Arbitration (Scotland) Bill and the development of a Scottish centre for Alternative Dispute Resolution.

The SG is also liberalising regulation of the legal profession itself, through the Legal Services (Scotland) Bill. This will remove restrictions on the type of business structures open to solicitors, opening the way to greater innovation in the legal services market. As well as creating more opportunities for the Scottish legal profession, this has the potential to support better, more holistic services for the wider financial and business sector, in areas such as regulatory compliance, risk management, mergers and acquisitions, and so on.

ASSESSMENT OF THE EFFECTIVENESS OF INTERACTIONS

As previously discussed the vast majority of the public sector interactions with this key sector are in relation to financial services rather than business services. However, SG, SE, SDI and HIE key sector teams have now begun to consider how best to identify appropriate interventions in the Business Services Sector and SDS has appointed a Financial and Business Services Sector Manager. These Key Sector Teams will work to identify which sub sectors within the Business Services sector have the potential for growth or improvement in productivity with public sector intervention or where we can better leverage the existing linkages with financial services to the benefit of both industries and Scotland's economy.

Strategic Level

- There is an effective partnership in place between the public sector and the industry in delivering the *Strategy for the Financial Services Industry in Scotland* over the last four years.
- This collaborative effort was initiated in the original group which developed and then published the *Strategy* in 2005. One of the recommendations of the Strategy Group was to set up FiSAB to ensure continued collaboration between the industry and the public sector.
- The work of FiSAB and FiSIG which is reported upon annually is not only extremely important in terms of delivering the aims of the strategy, but is itself used as part of the Scottish proposition used by e.g. SDI when attracting FDI from financial services organisations.

- In late 2008 the relationship between the SG and the financial services industry formed part of the presentation made to Lloyds TSB by the Scottish Government in making its case for retaining key corporate and decision making functions and jobs in Scotland following the proposed merger with HBOS.
- FiSAB produces a report of progress annually. The Annual Report[9] outlines a comprehensive list of achievements across the three strategic pillars; People, Profile, and Infrastructure.
- It also discusses progress on a number of indicators, such as employment, qualifications, contribution to GDP, and earnings, which provides a system of measurable outcomes to gauge the success of the industry. Achievement of these outcomes should also have a positive impact on helping the SG achieve the overall Purpose of increasing sustainable growth.

Operational Level

- On a day to day basis, having sector-specific teams within SG, SE, SDI and SDS has meant that close liaison and partnership working within the public sector has been easy to maintain.
- With close ties established between all four teams, a cohesive response to industry needs has been achieved. Representatives from all four teams are also now members of FiSIG which means that actions appropriate to individual teams are managed with joint working – providing industry colleagues with simplified (one-stop) access to the public sector. Examples which provide an indication of the effectiveness of interactions in the year ended April 2009 are:

Regional Selective Assistance

- RSA has proved a valuable asset in attracting new companies to Scotland and helping established companies remain in Scotland to develop and grow. For example, Esure Holdings Ltd announced in February 2009 that it would be expanding its operation in Glasgow. The project is being supported with an RSA grant of up to £1.1m and is expected to create 250 new jobs, although the company believes that up to 500 jobs could eventually be created. Also, Barclays Wealth Management's operation in Glasgow is being supported with a RSA grant of £4.2 million, a project that is expected to create some 500 new jobs and safeguarding at least 800 existing jobs.

SMART: SCOTLAND

- It is safe to say that SMART: Scotland has, to date, had less of an impact on financial services companies than RSA. Although no grant has been made direct to any of the big financial institutions, grant has been awarded to a number of companies involved in the development of new technologies designed specifically for businesses in the financial services sector. These include Scalar Technologies Ltd who are developing an anti-counterfeit optical monitoring system and Level E Ltd who are developing artificial intelligence-based technologies for multi asset portfolio management.

Scottish Enterprise

- SE's financial services key sector team and SDI's financial services team both actively support the work of FiSAB and the *Strategy*. They have very close links with both indigenous and inward investor organisations and have been working recently to improve opportunities for the supplier network.
- Until the recent re-focus of SE and the creation of SDS, SE officials took the lead on actions in relation to workforce development and attracting talent to the industry. SE

[9] A copy of this and previous reports can be found at http://www.scotland.gov.uk/Topics/Business-Industry/support/finance

officials now lead on working with SDS in taking this work forward and ensuring a focus on the needs of the financial services industry.

- SE and SDI activity to promote Scotland as a hugely successful financial services centre with a strong legacy and a significant competitive advantage has seen major investment by international companies directly and indirectly involved in financial services. Since February 2009 alone, esure announced the creation of 500 new jobs in Glasgow, Tesco Bank announced 200 new jobs at its new HQ in Edinburgh in March; in June Virgin Money announced plans to create 100 Jobs in Edinburgh; and in August Tesco Bank announced the creation of over 800 new jobs in Glasgow while Capita announced 300 jobs at its insurance contact centre in Stirling - consolidating Scotland's position as the best performing region in the UK and a leading region in Europe for attracting FDI for financial services.

Highlands and Islands Enterprise

- HIE's focus is business services and has close links with key companies in the region, in particular long-standing relationships with inward investors who play a critical role in the Highlands and Islands economy. Work with these companies recently has included supporting pilot homeworking activity with BT and Vertex, as well as team leader development work with the Call and Contact Association (CCA) and the contact centre sector.
- HIE has an important partnership role with SE and SDI in promoting Scotland, drawing on related strengths in the outsourcing sector, and demonstrating real evidence of rural Scotland providing companies such as BT, Capgemini, Vertex, and their blue chip clients, with the benefits of access to a loyal and highly skilled workforce, excellent performance levels, and cost efficiencies from lower average rentals and equivalent salaries.

Regulation

- Although the regulation of the financial services industry is reserved to the UK Government, FiSAB has continued to discuss regulatory matters. Most recently, and in direct reaction to the global financial services crisis, FiSAB has agreed that Scotland required direct linkages with the UK tripartite authorities (HM Treasury, the Bank of England and the Financial Services Authority). Following various discussions, FiSAB has agreed to invite the Bank of England and the FSA to attend relevant FiSAB meetings. HM Treasury continues to provide an observer to FiSAB.

INTERNATIONAL PERSPECTIVES

The *Strategy* acknowledged the need to measure progress and to benchmark Scotland as a location against international and regional comparators. These comparisons are reported in table 2. International comparator locations are OECD members and include major economies such as the USA, Japan and Germany, while the regional analysis compares Scotland to the countries and regions of the UK (or GB depending on data availability). Similar analysis has not, to date, been undertaken on the business services sector. This analysis will be undertaken as part of a programme of work on the key sectors.

Section 1 noted the key role that the financial services industry plays in the Scottish economy, and table 2 confirms this position. For example, on international and regional comparators, the sector's relative position on a number of benchmarks is marked. Moreover, with the exception of exports per worker, relative performance has become more pronounced since 2000.

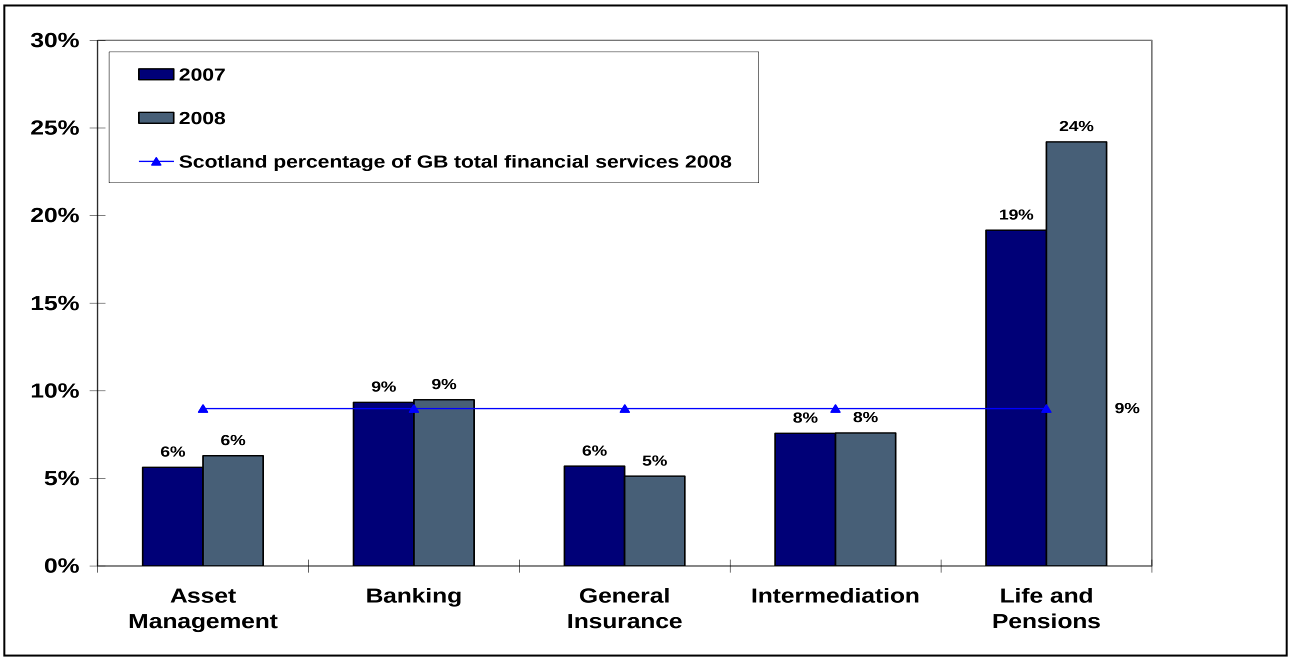
Table 2: Financial Services – International and Regional Benchmarks						
	International Comparisons			**Regional Comparisons**		
	Number of comparators	***Scotland's Position***	***Change in position since 2000***	***Number of comparators***	***Scotland's Position***	***Change in Position since 2000***
Share of total employment (2007[10])	28	9	▲[11]	11	3	◀▶[12]
Employment Growth 2006 - 2007[13]	26	14	N/A	11	5	N/A
Contribution to GVA (2006)[14]	26	6	▲	12	2	▲
Exports per worker (2006 international/2007 regional)[15]	30	3	▼16	UK as a whole	1	-
Average Earnings (international - 2007 or most recently available year) (regional - 2008)	23	6	▲17	11	2	▲18

Scottish Government
February 2010

[10] 2006 for France and Luxembourg. Regional comparison is with GB.
[11] Change in positions is from 2006. Due to a change in methodology, employment data for 2006 onwards cannot be compared with earlier years. No 2007 data for France & Luxembourg therefore only 26 comparators available.
[12] Comparison is with position in 2006 – due to a change in methodology in the Annual Business Inquiry; employment data from 2006 onwards is not comparable with earlier years.
[13] Change in position from 2000 not possible as employment data from 2006 onwards cannot be compared with any years previous.
[14] Regional data from ONS Regional Accounts.
[15] Data for Scotland is sourced from the Scottish Government's Global Connections Survey, for all other countries the source is OECD Trade in Statistics in which data is available in US dollars. In order to ensure data for Scotland is comparable, the sterling value of Scottish export data has been converted to US dollars at the same rate as the OECD converted UK data in sterling to US dollars, however it should be noted that comparisons of export values in different years will be affected by currency fluctuations.
[16] Change in position is from 2002.
[17] Change in position is from 2006 – due to change in methodology, earnings data from 2006 onwards cannot be compared with earlier years.
[18] Change in position is from 2006. Due to a change in methodology, earnings data from 2006 onwards can't be compared with earlier years.

FINANCIAL SERVICES EMPLOYMENT IN SCOTLAND – SHARE OF GREAT BRITAIN TOTAL BY SUB-SECTOR, 2007 & 2008

Scotland accounts for 9% of employment in financial services across GB, though the share of employment varies across sub-sector as below.



FINANCIAL SERVICES EMPLOYMENT IN SCOTLAND BY SUB-SECTOR, 2007 & 2008

The chart below demonstrates employment levels in financial services sub-sectors in 2007 and 2008, illustrating the dominance of the Banking sector in Scotland. In 2008 the sector employed 50,000 people, or 52 per cent of Scotland's financial services employment. The second largest sub-sector of financial services in 2008 was Life & Pensions, which accounted for 14,400 employee jobs.