OFFICIAL REPORT
AITHISG OIFIGEIL

Public Audit Committee

Wednesday 25 June 2025

Session 6

The Scottish Parliament
Pàrlamaid na h-Alba

Wednesday 25 June 2025

CONTENTS

PUBLIC AUDIT COMMITTEE

21st Meeting 2025, Session 6

CONVENER

*Richard Leonard (Central Scotland) (Lab)

DEPUTY CONVENER

*Jamie Greene (West Scotland) (LD)

COMMITTEE MEMBERS

*Colin Beattie (Midlothian North and Musselburgh) (SNP)
*Stuart McMillan (Greenock and Inverclyde) (SNP)
*Graham Simpson (Central Scotland) (Con)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Al Denholm (Scottish National Investment Bank)
Willie Watt (Scottish National Investment Bank)

CLERK TO THE COMMITTEE

Katrina Venters

LOCATION

The Sir Alexander Fleming Room (CR3)

Scottish Parliament

Public Audit Committee

Wednesday 25 June 2025

[The Convener opened the meeting at 09:30]

Decision on Taking Business in Private

The Convener (Richard Leonard): Good morning. I welcome everybody to the 21st meeting in 2025 of the Public Audit Committee.

Agenda item 1 is for the committee to decide whether to take items 3, 4 and 5 in private. Do we agree to take those items in private?

Members *indicated agreement.*

"Scottish National Investment Bank"

09:30

The Convener: The second item on our agenda is further consideration of the Auditor General for Scotland's report on the Scottish National Investment Bank. I am pleased to welcome our two witnesses. We are joined by Al Denholm, the chief executive of the Scottish National Investment Bank, and alongside him is Willie Watt, who chairs the Scottish National Investment Bank.

We have some questions to put to both of you based on the Audit Scotland report. Before we get to our questions, Mr Watt, I invite you to give us a short opening statement.

Willie Watt (Scottish National Investment Bank): Thank you, and good morning, everyone. We are pleased to be here to discuss the Auditor General's report.

The Scottish National Investment Bank was founded in November 2020. We are still a young organisation that is learning and developing, and we view an opportunity such as this as a dialogue that will help us in the way that we think about what we do going forward.

We have made significant progress since our foundation in developing processes, operations and governance, and we have built a portfolio of 43 investments with a committed capital of £780 million during that four-year-plus period.

It is worth remembering that the bank was set up to be an alternative to the Government giving grants. Grants, once made, are never recovered, while a commercial-first plus impact investment delivers much more for the public capital than a one-off grant does. We can develop that point further if the committee is interested; it is a fundamental premise of the bank's foundation.

Our role as an investor and our place in the market are still developing. I would not say that we believe that we are the finished article yet, but we are clearly much further down the road towards that than we were at foundation.

The Auditor General's report recognised the robustness of our progress against our missions and on the governance of the bank. It also highlighted the need for the bank to have the financial flexibility to fully develop into the effective development bank for the people of Scotland that it could be. We look forward, in particular, to discussing the issues and challenges around that need, and I should say that the board of the bank is entirely in agreement with the Auditor General's views on that particular issue.

The Convener: Thank you. On that final point, for the record, does the bank accept all of the report's findings, and is it prepared to follow up on all the recommendations that are targeted at the bank?

Willie Watt: Yes. The key recommendation that relates to us is a request for more transparency in decision making. We are moving in that direction and we are happy to move further with regard to that. Frankly, I think that that would be helpful for stakeholders of all kinds, so, yes, we accept that.

With regard to the matter of perpetual capital, which is how we describe the flexibility issue, we know that the Scottish Government will attend the committee in September, when no doubt you will be able to ask it for its views on that. However, we would underscore the importance of financial flexibility.

As the Auditor General points out, that has been a live issue since the bank's foundation. When the Scottish National Investment Bank Act 2020 went through, there was an expectation among many people that it would be a perpetual institution. It then hit up against public sector accounting rules. We have been trying to unravel that conflict ever since, with action required by both the Scottish and United Kingdom Governments to do that.

Some progress has been made. The Scottish Government has given us limited flexibility with our year-end capital of £25 million in both directions, and the UK Government has published a couple of reports on public finance organisations such as ours, the National Wealth Fund and the British Business Bank, giving us a route towards perpetual status.

The Convener: During the course of this morning's meeting, we will probe those areas a little bit more. The environment in which you operate is one of the issues that is highlighted in the Audit Scotland report; it is certainly something that members of the committee want to ask the two of you about.

I invite Graham Simpson to open this morning's questioning.

Graham Simpson (Central Scotland) (Con): Good morning, gents. Mr Watt, I want to follow up on what you have just said about the UK Government giving you a route towards perpetual status. Will you say a bit more about that? What has the Government actually done?

Willie Watt: In October last year, the UK Government published what has become known as the PuFin—public financial institution—report, which is primarily about how the National Wealth Fund can become a perpetual institution. As I said in my introductory remarks, the financial flexibility problem is to do with UK Treasury rules, which impact other development banks as well as us. We view that report—and the one or two successor reports since then—as really important. It sets out the definition of what a public financial institution should be to have perpetual status, and we tick all the boxes for that. To be honest, I am not sure whether the Scottish National Investment Bank was at the forefront of the UK Government's mind when the report was written, but the fact that it is a principles-based report is helpful, because we meet the principles.

We are discussing with the Treasury how we can become part of the route forward to perpetual status, and the Scottish Government is having parallel discussions with Treasury officials and ministers on how that can come about. We will talk about what the problems are with our current status, but that could be a really positive route forward to dealing with them.

Graham Simpson: What would need to happen? Would there need to be legislation?

Willie Watt: Yes.

Graham Simpson: Would it need to be UK legislation?

Willie Watt: The UK development banks would require UK legislation, but we would probably require Scottish Government legislation as well. The complexity is that our funding comes through the devolved settlement rather than direct from the Treasury, so there is an additional layer of financial rules that would require to be amended.

Graham Simpson: I was going to ask about that. Most of your funding so far has been from financial transactions, and they have to be repaid to the Treasury. Does that cause issues?

Willie Watt: Not from an operational standpoint, because the responsibility for repaying financial transactions sits with the Scottish Government. The Scottish and UK Governments look at financial transactions as a unified pot, so there is no pressure on us to return capital to the Scottish Government and then on to the UK Government.

Graham Simpson: The responsibility is the Scottish Government's rather than yours, so you do not have to worry about it.

Willie Watt: That is correct. There are a lot of things that we have to worry about, but that is not one of them.

Graham Simpson: That is useful. I was just wondering whether that affects your target rate of return. Given what you have just said, I think that it probably does not.

Willie Watt: No, it does not. The target rate of return is really all about investment input factors.

Graham Simpson: I genuinely want you to help me out, because I do not know the answer. Your target rate of return is 3 to 4 per cent. I looked at that and thought that it did not sound particularly high. I could probably get better than 4 per cent just by going to a bank or some other financial institution.

Willie Watt: Yes. You would get better than 4 per cent because you would put it in a long-term deposit account, where it would be in cash, in effect. As a development bank, we cannot do that and you would not expect us to. We think differently about our target rate of return.

We are looking for a commercial positive return—it is not like a grant, as I said in my introduction. We are looking for a return that is at a level that could crowd in private sector capital, so it cannot be ridiculously low, but we are also a development bank that has been specifically tasked with taking more risk than the private sector. The final point that I should make is that we do a lot of different things, from investing in funds, which is low risk, low return; investing in debt, which is a little bit higher risk but modest return; and investing in equity, which is very high risk but potentially very high return.

Our balance sheet is more like that of an asset-owning entity such as a pension fund, than that of a fund, because we do not one thing, but four or five things. We bottom-up model what we think the return should be for each of those buckets, but then we hit a much higher loss rate against that, and that is what brings the target rate of return down to 3 or 4 per cent. We benchmark against other development banks around the world and broadly speaking they are all around that rate of return.

I am looking at my notes because I wrote down that the UK Infrastructure Bank, which was the precursor to the National Wealth Fund, has a 2.5 to 4 per cent target rate of return. The British Business Bank has a 1.2 to 3.2 per cent target rate of return. The returns are about a combination of financial return and being a development bank, and we are trying to make sure both that there is a positive return to the public purse and that we do all the other stuff. I hope that that is helpful.

Graham Simpson: Yes, that is very helpful. You mentioned other development banks that have been around for longer. I would like to know what they actually achieve, as opposed to what their target rate of return is.

Willie Watt: That is a good and interesting question. It depends, because they all have different remits. One of the most interesting is KfW Development Bank, the German development bank, which has been around for about 80 years. It is a powerful institution that intervenes in the German economy in lots of different ways to try to precipitate growth and development. For example, it does a lot in public housing, as a housing bank. The Connecticut Green Bank—its name suggests what it does—is much more about net zero projects in the state of Connecticut in the United States.

What mature investment banks also illustrate is an ability to raise money from lots of different sources; they usually borrow on their own balance sheets. Our ambition is to become much freer of public sector financing. It is not that we have any ambition to not be in the public sector, but we want to be free of public sector financing. If you look at those sorts of organisations, you will see that they are much freer than we are.

09:45

Graham Simpson: Do you know what the organisations that you have mentioned—KfW and the Connecticut Green Bank—are achieving?

Willie Watt: In terms of returns?

Graham Simpson: Yes.

Willie Watt: I do not want to quote numbers off the top of my head, but broadly speaking, they are in the kind of range that we are talking about—that is, the lower single digits. I am sorry; I misheard your original question.

Graham Simpson: No, that is okay. That was really useful.

You will invest in a company, no matter what stage it is at. I think that I am right in saying that you have £10 million in the fast-growing property app firm, Utopi, and you own some shares in that. How do you anticipate getting a return on your investment in companies? There are probably different ways, but could you just tell us one of them?

Al Denholm (Scottish National Investment Bank): The example that you have mentioned is an equity investment. You are right: we have £10 million in that one, give or take a few rounding errors.

Utopi has been awarded a number of accolades over the recent year; it was one of Deloitte’s technology fast 50 companies and it has been noted in a number of awards. It is a real success story for Scotland, and we came in and provided it with equity. As it continues on its journey, it will, over time, seek further equity and look to other institutional investors and we will exit in due course. That will not happen in the near term, because we can ride that growth and the growth in the value of the investment. I do not know what the timeframe will be, but it will not be a short number of years; we are talking about the medium term, because a development bank is all about long-term investment and patient capital.

At some point, though, we will exit and recycle that money back into other opportunities. Using your example—which is a great one, so thank you for the question—we can take the success of such a company, put the proceeds back into another company at some point in the future and create that perpetual fund. Actually, it also provides a good example of what a perpetual fund means. That is how we would get our value. In the meantime, as the company grows in value—as one assumes that it will, because of its business performance—we will take it through our valuation process and reflect that in our target rate of return and our actual returns with regard to the value of our portfolio at the point in time when it is revalued.

Graham Simpson: You are right—the company appears to be doing very well and has won some plaudits. At some point, though, you will have a look at what your shares are worth and, if they have gone up by a certain amount, you will cash them in.

Al Denholm: Effectively, yes. That is pretty normal for private asset investors. We are not doing anything different from anyone else.

Willie Watt: We will work with the management on its plans. As Al has said, there comes a point with software companies when they will either list on the stock market or be bought by a bigger software company. It is unusual, but we have covenants in our investment agreements that tie the companies that might buy Utopi to Scotland. Obviously, as a development bank, we want the returns, but we also want the jobs and the intellectual capital to reside in Scotland, and we have covenants about head office and those kinds of things.

A company such as Utopi comes under our innovation mission. We do not think that Scotland has enough well-paid jobs, enough growth or enough businesses of the future, and we want to replicate what might be called the Skyscanner effect. You have a unicorn-type business that employs a lot of people in Scotland; when it gets sold, a lot of people, including quite junior people, make some money; that money gets recycled in the economy, and people who worked in it go out and found other businesses. We are trying to stoke the engine of that virtuous circle.

Graham Simpson: What you do not want—we have seen this quite a lot in some sectors—is a company like that doing really well, then being bought over and moving somewhere else.

Willie Watt: Indeed. That is what we do not want.

Graham Simpson: You see it happen quite a lot in the life sciences sector, in fact, and we do not want it. How do you prevent it?

Willie Watt: Well, we prevent it partly in the way that I have alluded to—that is, by putting things into the investment agreement that the company has to sign up to. We also prevent it by taking a patient view and not forcing it to exit. As I often say to Al and the team, we should be taking a longer-term view of these things than a conventional private sector investor would, because we are a development bank and because of exactly the point that you have made.

Al Denholm: There is another angle to your question. A founder will come up with a great idea in, say, life sciences; the funding will come from some other part of the world; and the funding agreement with whoever it might be will say, “Well, we will fund you, as long as you move to Boston.” Therefore, one of the roles of the Scottish National Investment Bank is to provide local funding to those businesses to try to ensure that they stay in Scotland. That was one of the premises behind setting up the bank in the first place.

Graham Simpson: Okay. I am going to move on to the one disaster that you have had. You have been asked about this before; indeed, I have asked you about it before, Mr Watt. Circularity Scotland was a disaster—there is no other word for it. What lessons have you learned from that?

Willie Watt: Do you want to take that question, Al?

Al Denholm: I was actually asked about that a few months into my tenure, and it was quite useful to go back and have a look at the lessons learned. I looked at it through the lens of a chief investment officer or chief executive officer, which involved looking back over the audit trail, my colleagues’ approach to that transaction or investment and the course of that journey.

It was a multistage process, as any investment process is, and with my experience as a professional investor who has been in the business for a long time, I thought, when I looked back over the process, that it was robust. The actual elements of the due diligence that were done were what I would have expected, had I been working for any other well-known asset manager. I have worked for a number of them, so I recognised what I saw.

As we went through that process, we obviously took into account some of the macro factors that were relevant to the business. As you do, you look at micro and macro factors, and among them, we noted that deposit return schemes were prevalent globally and were also part of the policy framework and direction of travel for the UK Government, the Scottish Government and the Welsh Government.

We took that to be what we called at the time—and as you will see if you look back through our papers—a risk mitigant.

What we did not expect was a reading of the United Kingdom Internal Market Act 2020 that led to a difference in view among certain of thee players. In the spring of 2023, the UK Government said, “We are happy to do this, but not until 2025.” That was when the investment started to unravel and the administrators were called in.

There was a sound basis for the thesis that deposit return schemes would happen, but, with 20:20 hindsight, we can see that we did not anticipate the issues with the actual implementation of the scheme between different parts of the UK Government ecosystem. Ultimately, that is what led to the decision to delay the scheme and to the business failing.

Willie Watt: We underestimated the politicisation of the deposit return scheme between the UK and Scottish Governments. With hindsight, I think that the company itself made the mistake of focusing on getting the commitment of all the big producers and retailers of plastic, all of which signed up to the scheme, and not carrying the small producers and retailers with it. The small producers and retailers did not like the scheme, as you will remember—I am sure that, as MSPs, you had letters from them. Therefore, the commitment to the scheme started to drift away. I agree with Al Denholm that, with hindsight, we can see that our judgment about the risk of that happening was wrong.

Graham Simpson: That is very honest. Perhaps one of the lessons should be that, because you see yourselves as independent from the Government, you should be very wary of investing in Government schemes, because they can become political, as that one did. Have you reflected on that?

Willie Watt: You make a good point, but the counterpoint is that, if you walk around Europe on holiday you will see deposit return schemes in most major European countries. From the point of view of our net zero mission, we thought that it was a really good thing that the country should do. That is where our big-picture enthusiasm came from, but there is something in what you say.

Graham Simpson: That is useful.

My final question is about the turnover of chief execs. Mr Denholm, you are hoping to retire at some point, and we are recruiting for somebody else. I think that you are the third chief executive, and there was an interim chief executive. That is quite a turnover in a short period. Does that concern you, Mr Watt?

Willie Watt: Our first chief executive was in the role for two years, I think. Sarah Roughead, who acted as an interim chief executive, did the job for a few months, and Al Denholm will have been with us for two and a half-plus years before he retires. I am not concerned about it because of the bank’s ability to drive forward—bearing in mind that our first chief executive joined the year before the bank was launched, so we are talking about a five and a half to six-year period since the first CEO was appointed. We have demonstrated significant forward momentum in the organisation, and I was highly supportive of the individual decisions that were made around those people. As you would probably expect me to say, I am not concerned.

Graham Simpson: I think that I am right to say that it took a while to recruit Mr Denholm. Is there a good level of interest in the job now?

Willie Watt: Yes. I have just come out of a meeting with our search consultants, and there is a good level of interest, including international interest. However, it is a difficult job; it is not an easy job. Some people do not like doing things such as this evidence session, for example—they find them quite difficult—and there are challenges with regard to remuneration and the public-private place that we sit in the middle of.

On the other hand, there is huge enthusiasm for the missions and real enthusiasm for making a difference in Scotland, not only on the part of Scots or returning Scots but on the part of people who are just excited about what a development bank can do in a country of this size. As we all know, it is a small country, and there are advantages to that as well as disadvantages. I am very confident that we will be able to hire the right person, but, as a board, we are very aware of the challenges in hiring the right person.

10:00

The Convener: Jamie Greene has a question about Circularity Scotland before we move on.

Jamie Greene (West Scotland) (LD): Good morning. You have just been asked about the lessons that were learned from the experience with Circularity Scotland, and I listened with intrigue to your responses. What I heard was a summation of what went wrong with the deposit return scheme and Circularity Scotland. We already know what went wrong with them; what I did not hear was what went wrong in your internal decision-making and risk-assessment processes. Mr Denholm, you said that you were confident that robust processes were followed in the decision making that led to the initial investment. Mr Watt, you seemed to suggest that you were somewhat surprised by the politicisation of the issue. The scheme had been highly political since it was first mooted by the Government, and anyone worth their weight in research would have been able to tell you that, so I am still struggling to understand who in your organisation made the decision that the risk was low enough. In what way was it not going to become a political issue? I ask because I am particularly nervous that 50 per cent of your investments are in the net zero space, and we all know that there are shifting sands around these issues.

Willie Watt: I do not accept your premise that we did not go through our processes properly. The issue with investments is that you always look like an idiot if the investment goes wrong—by definition, because you have the benefit of full hindsight. Al Denholm was articulate in his review of the processes that we went through. I was on the investment committee that made the decision, so I am happy to own our decision on Circularity Scotland. Clearly, we discussed the political risks, so it is not as though we thought that there were no political risks. We thought that there were political risks, but we underestimated the politicisation of the scheme. Although it was political because it was introduced by the Government of the day, it had support across the whole of the UK—there was a different political party in government in Westminster at the time—and it was the settled policy of both Scotland and the UK.

The issue became significantly more politicised as it unfolded, and I thought that I was making an insightful comment about the fact that that politicisation was to do with the fact that the company was not particularly successful in carrying all stakeholders with it, particularly small producers, small independent distilleries, small independent brewers and small independent retailers such as tobacconists and newsagents. That increased the politicisation significantly in Scotland, and there was then a disagreement to do with the interpretation of the internal market act in relation to whether Scotland's scheme could include glass and plastic versus a scheme in the rest of the UK that would include only glass, and that—

Jamie Greene: Would you not have unearthed those issues before committing £9 million of public money to the investment?

Willie Watt: We could not unearth the issues around the politicisation of the small stakeholders, because we were not aware of them. We looked at the internal market act, but we thought that there was a way through that, which was the commonly held view of most people at the time.

Things change. We will make losses in this bank. The thing that has surprised me is how little we have lost in the four and a half to five years that we have been in business—not how much we have lost. I deeply regret the loss of the deposit return scheme and Circularity Scotland capital. We are not complacent about what we have learned about that. I was honest with Mr Simpson in response to his challenge about investing where things are political. We got it wrong, we made a mistake, we own the mistake and we try to move on.

Jamie Greene: That is fair enough. Thank you.

The Convener: This is bringing back lots of memories for me of meetings with the Scottish Grocers Federation, visiting glass manufacturers in Ayrshire and so on, but that was some time ago.

Stuart McMillan will now put some questions to you about the broader environment that you operate in.

Stuart McMillan (Greenock and Inverclyde) (SNP): The mention of Europe took me back to 1994 and my studies in Germany, where a deposit return scheme was in operation.

Willie Watt: All those years ago.

Stuart McMillan: Yes, absolutely. I grew up in Port Glasgow, where, apart from some juice bottles, recycling was not really much of a thing, as you know.

The bank operates with single-year funding allocations from the Scottish Government, and there will obviously be some challenges with that. You touched on that area in your earlier comments. I am keen to get a bit more understanding of how you manage to deal with that and align funding with commercial activity, including in relation to your preparedness and ability to manage investment losses.

Willie Watt: It is a big challenge. The bank gets an annual allocation from the Scottish Government that we cannot go above, because there would not be any available capital to finance it. Therefore, we have to structurally undershoot every year. When we go into the final quarter, we look at investments that we can make. Al Denholm manages the pipeline, and we look at how long it takes for individual investments to go through the legal and diligence processes, which can vary—they can shoot out or pull back. We then have to make a decision as to whether we can commit finance and, if so, to what level.

The challenge is that we do the diligence and then decide not to do something. There was an instance in the financial year that has just ended when we were really excited about a company and were going to commit £30 million of capital to it, but we then found out things about it that completely changed our view. That £30 million was slated to complete in the year, but we then had to pull out. It was too late in the year to invest it in anything else, so we did not meet our deployment target.

Most public bodies operate under an annual funding regime—it is not unique to the bank—so we have been discussing with the Deputy First Minister and her exchequer colleagues the ability to have some degree of flexibility at the year end that would allow us to better manage our capital. We have been granted flexibility to overshoot or undershoot our budget by £25 million in any one year. That is helpful, practically, but it does not go as far as we would like.

Stuart McMillan: Is that flexibility already in operation?

Willie Watt: Yes.

Stuart McMillan: When did that come in?

Willie Watt: It came in at the end of the most recent financial year—so, very recently.

Stuart McMillan: Okay. You gave one example, but are there any other examples—I am not looking for the names of companies—where the lack of flexibility has had an impact on what you do?

Willie Watt: It is also a problem when the diligence takes longer than everyone thinks that it will, or the putting together of the other funding around the project takes longer, which is quite common. If the project then runs over into the next year, we eat up next year's budget for something that we could have potentially invested in this year. Of course, the bigger the projects are—we can invest up to £50 million—the more of a challenge that could be.

Stuart McMillan: Mr Denholm, do you want to come in?

Al Denholm: I would say that the issue is peculiar to an investor acting in the public sector. I worked in the private sector for the past 37 years of my career, and it was never an issue. The due diligence took however long it took, the pulling together of the group of investors took however long it took, and if things fell over and took another two months, they took another two months. Therefore, we face a unique challenge.

As Willie said, on the other side of the coin, we cannot overspend. To some extent, we are trying to thread a needle, but you should be assured that we will not deploy for the sake of deploying—we will make the right decision. The decision not to deploy that Willie referred to was the right investment decision. I would like to think that you would take comfort from that decision.

Having flexibility will help in that regard, because if you are doing a deal—or making an investment; "deal" is our terminology—you want to ensure that you make the right investment and carry out the right due diligence. Sometimes, that just takes longer; sometimes, it is quicker. Having perpetual status will also help us in that regard, but it is unusual for an investor to have such a constraint.

Stuart McMillan: That is helpful, thank you.

Mr Watt, earlier, you referenced two banks—KfW and the Connecticut Green Bank. KfW is a state-owned bank—I checked that a few moments ago. Every country has its own set of financial rules, but do the German banks operate between the federal Government and the Länder Governments? Do they operate under something similar with regard to the year end?

Willie Watt: The short answer is that I do not know.

Stuart McMillan: I asked that question because, as you indicated, KfW has been around for 40 years, and SNIB has obviously been around for a lot less time. Are the drive that you want to see in SNIB and the direction of travel that you want to take the bank in akin to those of the KfW?

Willie Watt: We are a long way short of what KfW has achieved, but it would be an aspiration to be as powerful an institution in the long term.

The problem with budget is one that other development banks around the world have, because Governments tend to think in annual cycles. That is why the other development banks in the UK, such as the National Wealth Fund, have the same problems that we have.

The Treasury is now trying to think that through because there is more of a political consensus that development banks are a good thing. The previous Conservative Government founded the UK Infrastructure Bank, we were founded by a Scottish National Party Government and Labour has beefed up the UK Infrastructure Bank with the National Wealth Fund, so I think that there is a political consensus around the role that development banks can play in the UK. However, nobody has properly thought through how you change public sector accounting rules to allow development banks to do what they are set up to do. We are playing a bit of catch-up.

We have been around for four and a half years and the issue has been one of the key things on my agenda to address since I was appointed, but we have not solved it yet. If you want to criticise me for something, criticise me for that. As I said in my introductory comments, I think that there is a window of opportunity to do something and make it work.

10:15

Stuart McMillan: That is very helpful. You have indicated that you genuinely want the bank to operate as a perpetual investment fund, but it is clear that the funding rules are getting in the way and are stifling some of that.

Willie Watt: The other important element that we have not talked about is that, at the moment, we have to return capital flow to the Scottish Government. If we could keep that in the bank, we could reinvest it. We have spoken about Utopi. It is a big if, but if that is a great success—we could be talking about that happening in 10 years' time—we would want to reinvest our profits in 10 other Utopis but, at the moment, we could not do that.

Another issue that the committee will be concerned about is that, if we make losses—I can assure you that we will have more losses—there is nowhere to write them against apart from the central Government account. However, if we were a perpetual institution, we would write them against our balance sheet. If we made a large profit from Utopi but we lost a lot of money on the deposit return scheme, those could be netted off against each other, but we do not have that ability. Having perpetual status would be good for the bank, but it would also be good for our public governance, because it would prevent surprises from hitting the Government's accounts.

Stuart McMillan: There has been a bit of movement with the £25 million of year-end flexibility, which is positive. Have any other elements of additional flexibility been provided to the bank?

Willie Watt: No.

Stuart McMillan: If there are no further changes to flexibility, how do you see that affecting the bank over, say, the course of the next five or 10 years?

Willie Watt: We will still make investments and I hope that the net of them will be positive, but we would not be able to grow and become more influential, and we would still be totally reliant on Government funding. The bank's vision is, ultimately, to be completely self-funding. We will still be the Government's development bank, but the Government will not have to put any annual budget in at all: it will all come from our own resources. Once the bank becomes self-funding, it could then borrow on its own balance sheet. KfW gears its balance sheet significantly, which gives it even more capital. If we can nail that, the whole thing could become a self-perpetuating positive; otherwise, we will just continue to operate as we have been.

Stuart McMillan: Is that the same across the UK for other development banks?

Willie Watt: Yes. When I speak to UK Government ministers, I am keen to emphasise the importance of treating the Scottish National Investment Bank in the same way as the National Wealth Fund. We want to be treated in a similar way, because we think that our missions align with Government policy, whether that is UK Government policy or Scottish Government policy.

Stuart McMillan: Is it correct that that would not reduce the level of governance and oversight that the Government and our committee would have in relation to the bank?

Willie Watt: Yes. It would not change our oversight arrangements or our ownership at all. We would still be completely accountable to the Government. The accountability would probably increase, because the more important the organisation became, the more important it would be to have accountability.

Stuart McMillan: That is helpful. Thank you.

The Convener: Before I bring in Colin Beattie, I want to take you back to your answer to Graham Simpson some time ago, when you said that changing the public sector regime would require legislation. Would it not just require a change to the Treasury rules? In other words, have you done any research that leads you to the conclusion that a change in the law would be required, rather than it just being a matter of reforming the way that the Treasury works?

Willie Watt: I think that it is a bit of both, to be honest. Undoubtedly, there is an element of changing the rules. They are there for a good reason—

The Convener: Arguably, Mr Watt—I have found that the Treasury is not always right.

Willie Watt: I am sure that that is right, but you can understand why it wants to try to control how much is borrowed. I may be wrong and, if I am, I apologise to the committee, but I feel that there is a requirement for a change in legislation, although I cannot quite put my finger on why I think that. Apologies for being uncertain about my answer.

The Convener: That is fine. If you have the opportunity to put something in writing to reflect any research that you have done in that area, that would be helpful for the committee.

Willie Watt: We will definitely do that.

The Convener: It might be easier to change the law than it is to change the mind of the Treasury. [*Laughter*.]

Colin Beattie (Midlothian North and Musselburgh) (SNP): I would like to look at governance, operational arrangements and independence. I am pleased to see that the bank has established sound governance and reporting arrangements from the outset and that it has a clear decision-making framework in place, which is really important. The Auditor General's report says:

"From the outset, the bank developed governance arrangements which met its public sector requirements, while also being aligned with the private investment finance sector."

How difficult was that, and how effective has that been?

Willie Watt: I will ask Al to respond.

Al Denholm: For context, I have worked in the financial services sector for a long time, and I have been on senior leadership teams in the sector during that period, so I know what governance arrangements should look like. The governance arrangements that have been set up for the Scottish National Investment Bank are similar and recognisable to me. The bank has a board, an audit committee, a remuneration committee, investment committees, finance committees and so on: it has everything that you would expect it to have. It has good internal governance arrangements, and internal and external auditors who check to ensure that it is operating to the right standards. The board sets the strategy and holds the executive to account, and the executive team executes the strategy. The design follows the private sector and public limited company model. I think that that is operating well, as has been recognised in the report.

However, we are not in the private sector, we are owned by the shareholder, so, as is right and proper, there is additional public sector oversight. We have, rightly, been set up to be held to account by the public sector, MSPs and the Scottish taxpayer. I stress that, under the Scottish National Investment Bank Act 2020, the bank was set up by design to be operationally independent. We need to make investment decisions for the right reasons, rather than being led in a certain direction, and I think that we are striking the balance quite well. We have what we call a shareholder team, which acts as the conduit on a daily and weekly basis and keeps an eye on us on behalf of the Scottish taxpayer. We agree with the Auditor General's report, which said that that arrangement is sufficient, but it is not overreaching—I forget the exact words—and that it strikes the right balance.

There is also the ministerial advisory group, which has been set up to advise the Deputy First Minister on the bank, but it does not play a day-to-day governance role in relation to us—it does not advise our board or double-check us.

We have a robust, recognisable framework. As we continue the journey that we are on with regard to Financial Conduct Authority authorisations, that framework is what a regulator would expect to see of an asset manager, which is what we really are. If we are to manage money on behalf of others in due course, which is our ambition, we need to be recognisable to a regulator that also regulates other investment institutions.

I hope that that was not too long winded an answer, but I thought that it would be useful to draw out the comparisons and the differences.

Willie Watt: We did an exercise mapping the governance requirements of a public body against the governance requirements of a company. As you would expect, there is a lot of sensible overlap, but where there were differences, we made sure that those were carried forward into our governance framework.

We also have what is called a shareholder framework document, which is basically a contract between us and the Scottish Government. It specifies what is the responsibility of the bank and what is the responsibility of our shareholder. That is a really helpful document. It is a public document—it is on our website, so people can look at it and see what is in there.

You are right that a complex mapping exercise is necessary to make sure that we get the best of both worlds, rather than the worst of both worlds.

Colin Beattie: Do you get any feedback from the market on that? Is there a market view on that?

Al Denholm: I would not say that we have had feedback on that, but it is very useful that we are seen to be commercial by those that view us as a commercial investor. We think that we are also seen to be doing the right thing by the stakeholders in the public sector world that have been tasked with having a view on us.

We have many different stakeholders, so the market consists of lots of people. As we go on our journey towards managing assets on behalf of other people, it is important that we are seen to be acting commercially at all times. If we are to manage money for X, Y or Z institutions in the future, it is important that we are seen to be acting independently and commercially. We have had no negative views on that—we get positive, affirmative views when we talk through our processes and governance structures.

Willie Watt: When the bank was founded, there was a lot of scepticism about our operational independence. I would not have agreed to become chair of the bank if I did not think that it would be operationally independent, but it is necessary to prove that. It is a legitimate concern. There is a lot less of that scepticism now, but that was probably the biggest challenge. People thought that we were simply a Government department and that we would do what we were told and would not be independent, and they wondered whether they could trust an organisation like that. There is a lot less of that now, but that was probably the biggest challenge that we had to face in relation to the public-private issue.

Colin Beattie: I will ask you several questions at once. Will you set out the criteria on which you base your investment decisions, the lessons that you have learned from your activity to date and the progress that you have made in implementing changes to investment strategy and investment decision-making processes?

Willie Watt: Do you want to kick off on that, Al?

Al Denholm: Absolutely. I jotted down the three questions—they were about the criteria for investment decisions, the lessons that we have learned and the progress that we have made.

10:30

I hope that this will come as no surprise, but the criterion that we look at is whether we will get a commercial return. Do we think that the business opportunity in which we are investing can earn us a good return on our capital in due course, either as an equity investor, a fund investor or a debt investor? What are the outlook and opportunities for the business? How do we think that the business will perform with regard to harvesting that opportunity? From experience, I would say that that is the exactly the same investment process that any investor would go through.

We have a full investment process sitting behind that. It is a bit more detailed than the three lines in the report, but we assess every new opportunity through those lenses in what we call a new business forum. That is the first part of our investment process; it is, if you like, the filtering stage.

If the business opportunity passes that first forum stage, we will take it through a much more detailed due diligence process, digging deeper and deeper and double checking that we have the right investment thesis and that that thesis stands up. At that point, we will do intellectual property due diligence if that is relevant, management due diligence, market due diligence and so on. It is all about digging down in depth, forming a deeper position and ensuring that we are happy with the financial model that underpins the business. Finally, we will make a yes or no decision to invest.

That is the investment process, but you also asked about the lessons learned with regard to investment. We have been in position for four and a half years. The day we started, everything was new. We had a new team with new people working together, processes had to be developed and so on. Over that period, we have taken our learnings and, last year, we enhanced our processes—I was going to say "refreshed", but that is probably the wrong word—to fine-tune some elements. Actually, we tried to remove duplication from our process to speed it up and make it more efficient, because we had had some feedback from the market that we were a bit slow. That first phase is now a lot quicker—not weaker, I should say, but quicker. We have also gone through the rest of the process to ensure that everything does the right thing at the right time and to remove duplication so that we can do things efficiently. In other words, we have improved what we think are the mechanics of our investment process.

We have also done lessons learned work, and we have thought about the areas where we need to learn from that work. With innovation, for example, we have moved our TRL—or technology readiness level—rating, which is shorthand for the stage that a company is at, from 3 to 5, say, to 8, to be a bit more certain that the commercial traction is there. What that means is that we are thinking that a company is in its scale-up phase rather than still in the laboratory, if you like. That is the difference. We found in our lessons learned work that we thought that we could add more value in the scale-up phase.

We also have to ensure that we get the right investment governance in place in the companies, that the board of directors are of the right calibre, that they have the right management team and so on. Those are the kinds of investment lessons that we have learned.

We are looking—and, I would like to think, will continue to look—to improve and to have an investment-lessons-learned mindset for the rest of our business. I have worked in 200-year-old businesses that were still looking to improve, year in, year out. I would like to think that in the next 30, 40 or 50 years, the bank, as it becomes a perpetual fund, will continue to improve and do things better. I see that happening internally, and I think that you have to put it in the context of our age and our positive learning mindset to try to get better.

Colin Beattie: I realise that we are still in the early years of the life of the bank and that there will be development. You previously mentioned asset management and so on, and you have expressed your ambition to broaden the bank's activity into the provision of advice, investment arrangements, the management of third-party capital and so on. How does all that align with the bank's core activities and purpose? We should also bear in mind that these are fairly complex areas to get involved in and come with new risks and new costs. The set-up costs of giving advice and managing people's capital will be very substantial. If you are actually going to be managing assets yourself, that will be a huge jump.

Willie Watt: It is an area that we are both very familiar with, because it is the world that we came from. We are very aware of what is required. The levels of governance set by the Financial Conduct Authority are very substantial, as you know from your background. We do not underestimate the change that would be required, but, since day 1, we have run the bank as if it were a regulated entity. As far as we could, we have put in place the systems and processes that are required.

Your point about activity being aligned with our core purpose is fundamental. If any third-party capital that we managed was not aligned with our core purpose, I would expect the committee to draw that out and quite rightly be very critical of that. As impact investing has developed as a commercial form of investment, there are now more organisations that we could invest in that share the values that are set out in all three of our key mission areas.

We are not primarily interested in giving advice or acting as an adviser, but the permission that we got from the FCA was really one that protected the bank. Sometimes, when we are putting investments together, we are stitching together different investors and companies. We advise them with a small "a" and say, "You should do this and we could do that, and if we all move together then this could happen." We did not want to stray into inadvertently giving advice, which would be illegal. At the moment, the permission that we have allows us to have regulated protection, so we can give advice as long as we follow FCA rules, but we do not see advice as an independent part of what we do. We will always be an investor rather than an adviser, but sometimes advice comes with investing.

The reason why we are interested in third-party capital and evaluating the risks that you quite rightly flag up is that we think that £200 million a year is insufficient to meet the bank's mission challenges. That funding can act catalytically—we can make good or bad investments—but our ability to move the dial would be much greater if we could manage third-party capital that aligned with our missions. It would also bring in more revenue to the bank, which would allow us to increase the staffing and resources at our disposal. We accept your analysis of the risks. We are deliberately moving slowly in that area, but broadening our activity very much remains our ambition.

Colin Beattie: Would you not be more or less compelled to separate those different aspects of the business into different companies, if you like?

Willie Watt: Yes. As you will know, the FCA permission that we have is for one of our operating subsidiaries; it is not for the bank's top company. We would manage third-party capital through a different subsidiary and we would be required to separate that out.

The fundamental premise would be side-by-side investment with what we are doing. We would not, for example, be raising third-party capital to do something that happened to be interesting commercially but had nothing to do with what the 2020 act tells us is our job, to which we are fully committed. It would mean, for example, that if £2 were required in an investment, £1 would come from the public purse and £1 would come from the private sector; however, it would be the same investment with the same objectives, the same governance and the same tenure in terms of time.

Colin Beattie: Would there not be a bit of complexity there, because you would have the parent company and one, two, three, or however many, subsidiaries? If people are going to put money into the subsidiaries, would there not be a requirement for a parent company guarantee for those subsidiaries? If so, do you have the power to do that?

Willie Watt: We do not think that there would be any requirement for a parent company guarantee, but you are right that there would be complexity. That complexity exists in the investment world anyway, because there are lots of investment entities that have different funds investing in the same investment. I do not underestimate the technical issues around managing it—and if we got it wrong, that would be a bad thing—but I think that it is a manageable risk.

Colin Beattie: Presumably, you are not going to be engaged in constructing new systems. Will you contract with a third-party provider and make use of their capacity?

Willie Watt: Absolutely.

Al Denholm: You made a point about putting money into a subsidiary. The money from a third party would not come into a subsidiary. If a subsidiary were managing a client's portfolio, the money would be ring fenced—it would be their money, and we would be acting as a fund manager of that pool of money. The money would not be commingled in the balance sheet in any way.

In that regard, you could think of our subsidiary, Scottish Investments Ltd, as having the bank—topco—as a client, and XYZ institution as another client, and it would provide the same services to different clients. The moneys would be ring fenced and you would not commingle them. I wanted to make that clear.

Colin Beattie: I was assuming that there would require to be a separation. It is still a big undertaking and getting the right people to do that will be an expensive business.

Willie Watt: I agree.

Colin Beattie: Although there is not a lot of capital needed to set up an asset management company, it will not be cost free. Do you anticipate the costs coming out of profits?

Willie Watt: Yes. We do not anticipate any public capital being required for additional staffing that might be associated with that. It is probably worth saying that, for the past two years, we have been operationally independent of the Scottish Government in relation to resource budget. We have had no Scottish Government resources to cover our operating costs and, touch wood, we perceive that that will continue.

If we were to make investments around third-party capital, those investments would come from surpluses that the bank had earned, rather than by asking the Scottish Government to increase its commitment to the bank.

Colin Beattie: I have one last question. You have emphasised that you operate independently of the Scottish Government in pursuing your missions. For the record, are you absolutely satisfied that you have no interference from the Government and that you have complete operational independence and freedom, within the constraints of the missions, as far as your investments are concerned?

Willie Watt: There is no interference by the Scottish ministers in our decision making, and there is no interference in how we generate the investment strategy that goes hand in hand with the missions. The Scottish Government has most influence on the bank in relation to public sector pay policy and, in that respect, we are significantly constrained—some might say appropriately so—in our compensation arrangements. In answer to your question, I would say that that is what comes to my mind as the major constraint on us. It is not about investment decision making, investment strategy or anything like that.

Colin Beattie: Coming back to what we were talking about with regard to future plans, if you had staff employed in subsidiaries, would their pay, too, be subject to the Government's constraints?

Willie Watt: Yes.

Colin Beattie: It would be.

Willie Watt: Yes.

Colin Beattie: Thank you.

10:45

The Convener: Funnily enough, the deputy convener has some questions in this area, too, as well as some others. Over to you, Jamie.

Jamie Greene: Thank you for setting me up nicely there, convener.

I will caveat my questions by stating two things. First, as the Public Audit Committee, we have a specific role in scrutinising the numbers. We make no apologies for that, but please do not take any of our questions personally.

Secondly, I would note that, overall, the Auditor General's report was perhaps at the more positive end of things, given some of the reports that we have seen in this room. I think that that is commendable and should be acknowledged at the beginning. I am not saying that just because you made a substantial investment in XLCC in my home region—although that, too, was very welcome—and I should also say that that will not influence my tenacity when it comes to asking my questions.

Let us start with your operating costs, gentlemen. My understanding is that, since 2020, you have spent around £41 million in operating costs—I have a little table that shows how much money you are spending on running the business. When it comes to income—and I appreciate that that is different from the profit that you will make from future equity or future exit strategies—the figure is £32 million, which makes a difference of about £9 million. You could argue that that is a loss, although I appreciate that, in 2023-24, the trend reversed. Is that normal in the first five years of a bank, first of all?

Al Denholm: I will happily take that question. As you can imagine, when you build a new organisation, there will be start-up costs and, effectively, a fixed cost element before you can get income coming in. That is no different for us from what happens in any other company. What we have been doing is building our momentum, if you like, and our portfolio, and income has been rising.

You will see that, as of last financial year, we are covering our operating costs through the income in our portfolio, and we would expect the gap in that respect to continue to widen. I would not expect things to stay so narrow; in other words, we will control our costs, our income will rise, and the jaws will widen going forward.

Certainly, that is our plan. We have what is called a one-plus-three financial plan as part of our business plan. That goes to our board for authorisation, and that is the pattern that we will see as we move forward.

Willie Watt: The difficulty was that we had to set up all the people and processes with no revenue, because we had no investments. As a result, in the first couple of years, we relied very heavily on the Scottish Government's support. Most of the operational losses—I am sure that we will talk about capital losses in a minute—happened in the earlier period. As Al Denholm has said, we hope—touch wood—that we will not be taking any more money from the resource budget.

Jamie Greene: I am sure that you have studiously read the *Official Report* of our previous evidence session in preparation for today's meeting. One issue that came up was the quite substantial difference between the amount of money that the Scottish Government had allocated to the bank and the amount that had been committed. I appreciate that not all of the investments will have been made in the financial year in which the deal, say, is agreed—I do understand that there will be a rollover element.

However, the numbers that I have in a letter of 16 June that we received from the Auditor General subsequent to that evidence session, and which I am sure that you have also read, point to a difference of around £70 million over the bank's five years between how much money the Government allocated to you and how much you committed to investments. That is a substantial difference. Can you explain it?

Willie Watt: There are a number of issues. One is the issue that we talked about earlier, which is that we always have to structurally undershoot. If the allocation is £100 million, we cannot go above that under any circumstance. Given that we are working on multiple investments with uncertainty around the timing of completion, we will always undershoot to some degree, but we try to get it as close as we can.

The second reason for undershooting is that, as we did with Circularity Scotland, we will get investments wrong in the future, although we will try not to. We will sometimes decide not to invest, and the cost of that is that we miss our deployment target. We perceive that to be the lesser of two evils, if you like.

The third issue is that you sometimes think that something will happen in one financial year, but it gets delayed and ends up happening in the next. Such things compound one another. The £25 million that we talked about earlier will help us with the problem that you highlighted, by giving us flexibility.

Jamie Greene: If you had the ability to roll over the underspend—I will call it that, but it is a non-committed allocation—you would effectively be sitting with a fairly chunky pot of cash at the moment that you could invest. Is that correct?

Willie Watt: Yes, it would make a difference. The other thing that I forgot to mention is that, in the first couple of years, we had an allocation but, as we were a start-up, it was quite hard, because we had to build a pipeline. Some of the underallocation was to do with that. There are a lot of different reasons for it, but you are right to highlight it in that way.

Jamie Greene: Okay. I am afraid that I now have some questions that are more icky. They might seem personal, but they relate to matters of public record. Mr Denham, you have resigned from your position. When did you do that? Are you serving your notice period at the moment, and what are the formalities around it?

Al Denholm: The formality is that I offered my letter of resignation at the beginning of April. I am working until a successor is found, which we assume will be at some point toward the back end of the year. I will stay on for as long as that takes and will not go away. I can tell you with certainty that I still do my job full time. I am not on gardening leave or anything like that, so I am fully committed, which is a point of personal pride. While I am around, I am fully committed to ensuring that the bank continues to fire on all cylinders and does a good job, and I want to give my eventual successor a good handover.

Jamie Greene: As a result, it is very good to see you here today. When you handed your notice in, did you have to give six months' notice?

Al Denholm: My employment contract is six months, but it does not matter if it takes six, seven, eight, nine or 10 months—I am here until Willie Watt finds someone. I am speculating, but if he finds someone after six months, that is great—I do not mind.

Willie Watt: Al Denholm has been really great at giving me as much flexibility as I need. He could have just said, "At the end of six months, I am out of here," but we are rolling things forward monthly.

Jamie Greene: That is good to know. You have not booked your cruise just yet, then.

The reason that I asked that question is that the scenario is very different from that involving the previous chief executive, who tendered resignation and very promptly exited the organisation. It is a matter of public record that he was paid a six-month salary in lieu. What is the difference in the two scenarios?

Willie Watt: The most appropriate way to deal with Al Denholm's retirement was to have a long-term handover, because he is totally committed, as he said.

The personal circumstances and the company circumstances were different when our first chief executive resigned. We felt that that was the right way to deal with those circumstances then, and I still think that that was the right way to deal with them.

Jamie Greene: You might have paid attention to the committee's work in relation to the departure of senior members of staff from other public organisations. We take quite a forensic interest in things such as notice period, exit sums and remuneration, and we are always keen to unearth the processes that were gone through, particularly when it comes to the chairs of organisations. Our interest in that is well documented, but I will not dwell on issues that are a number of years old.

However, the issue of salaries has come up quite a few times this morning. It seems to me—I mentioned this the last time we talked about the bank—that there is an inherent conflict of interests between working under the constraints of public sector pay policies, which most people would agree have certain caveats, and working for a financial institution. For example, it is very unusual to have bonuses in public sector organisations, but you have a well-structured bonus system. Talk me through that.

Willie Watt: Yes, it is unusual, but it is not unknown. It is more common when the organisation has a public-private interface, which a number of other organisations in Scotland and the wider UK do.

The board believes that bonuses align the performance and behaviour of the individual staff member with the organisation's operational and strategic goals. That is why we have a bonus scheme. Equally, we recognise that it would be inappropriate—especially in a public sector environment—to have a scheme that paid out all in one year, so our bonus schemes are structured as long-term incentive plans. They pay out over three years, with 50 per cent being paid in the first year and 25 per cent being paid in the following two years. The reason for that is that we want to bind individuals to the organisation on a longer-term basis and to make sure that they see their performance as being not simply a case of one and done, but as something that is more sustainable.

We also have clawback provisions in the schemes. In the investment industry, those are known as malus provisions. If there are any behavioural or significant performance issues, we can clawback bonuses. We have a robust set of rules around that, which are policed by our remuneration committee. Our remuneration committee is made up entirely of non-executive directors, who will look with a fine-tooth comb at the objectives that were set with regard to the bonus schemes and the performance of those schemes in any one year. Normally, about five or six different key issues are considered as part of the scheme. The chair of that committee is a very experienced chief people officer who has worked in the public sector and the private sector at a very high level, and she is all over the details.

We also have what is called a mission reward scheme, which is a bonus scheme that is aimed at all the staff in the bank. That is more about the alignment of the achievement of our mission impacts. It allows every employee in the bank to share in the success of those impacts on an annual basis.

11:00

Jamie Greene: If I was being pessimistic, I would say that it sounds like you are looking for reasons to pay bonuses that are not based on financial performance. The bank has turned a financial corner only this financial year but I presume that you have been paying bonuses for a number of years at a high level.

Willie Watt: It would not be right to pay bonuses based only on financial performance, particularly in a start-up situation, in which it is almost impossible to have financial performance. Therefore, the assessment of bonuses is based on a number of factors. Our investment deployment is one. We also look at impact performance, governance, people and culture, stakeholder engagement and financial performance. We try to take all of those things into account rather than focusing on financial performance alone.

Jamie Greene: Forgive me if I am wrong, but I got the impression from one of your earlier answers that you want to be free from the shackles of public sector pay constraints to allow you to recruit more aggressively, pay better and give better terms and conditions or to act as a quasi-commercial bank.

Willie Watt: I apologise if I gave that impression. If I am being honest, more freedom would be helpful because, ultimately, we are trying to recruit the very best people that we can to make the very best investments that we can on behalf of the people of Scotland. There is no leakage of profit out of the bank in any way. We are trying to find the best people that we can employ and deploy them towards our three missions.

I do not know whether you saw it but, recently, there was an interesting report by the Hunter Foundation that considered how different countries approach public sector pay generally. This is not for me to say but I will say it anyway: there is a general issue about whether we are setting pay for senior civil servants—people who run public bodies and do really big and important jobs for the state—at the right level. Do we have the right balance between being frugal with taxpayers' capital, which is clearly important—I can see why you are asking these questions—and having the right skill set to ensure that we do those jobs to the absolute best that they can be done?

I appreciate that it is a balance and there is not a right or wrong answer. I am certainly not advocating massively changing the way that people are paid in the bank. That is not my point at all. My point is that there is a balance in those things and we are all trying to get it right.

Jamie Greene: People who are watching this meeting might argue that £250,000 a year is a lot of money as a salary.

Willie Watt: It is a lot of money in absolute terms but we need to invest our capital alongside private capital. We are investing large sums of money and you rightly gave us a hard time about the deposit return scheme and Circularity Scotland. If we do not have the very best people that we can find, you will be giving me more of a hard time about investments that go wrong. Despite having the best people that we can have, we will still make mistakes on investments and lose money, so I am sure that I will be back at the committee in the future and you will appropriately ask me about losses that we have made. However, in the investment world in which we have to operate as a development bank, unless people have the right skill set, we are taking a massive risk.

Jamie Greene: I accept and acknowledge that. I am not entirely convinced that the argument that we should pay people more so that fewer mistakes are made is the right one to make—

Willie Watt: That is a fair point.

Jamie Greene: —but I see your point about attracting good talent. In addition, the big difference here is that, if someone wants to be paid a big-bank salary, they can go and work for a big bank. There is a burgeoning private sector that people can go and work in, but we are talking about a very different environment.

Willie Watt: Yes, of course. However, on the point about mistakes being made, the point is that, if we paid less, there would be more mistakes. That is my opinion.

Jamie Greene: I hope that that is not the case.

Willie Watt: Well, it is what would happen.

Jamie Greene: Before I move on to the next issue that I want to discuss, can you confirm that all members of staff at the Scottish National Investment Bank are resident in Scotland and pay taxes here?

Willie Watt: I do not think that I am in a position to confirm that.

Jamie Greene: It would be helpful if you could write to us with that information.

Willie Watt: I am not sure that I could write to you about that, because it is the Inland Revenue that is responsible for the definition of whether someone is resident in Scotland or England. I am not sure that we have the information you ask for.

Jamie Greene: I am sure that you do.

Willie Watt: We will write to you on the subject and try to clarify the position.

Jamie Greene: It would just save me having to submit a freedom of information request, to be honest.

Willie Watt: I understand. We will definitely write to you on that.

Jamie Greene: My final question concerns an issue that arose when we spoke to the Audit Scotland team, and it will lead into the final set of questions, which concern the balance of investments. That is an area that is of interest to me because of my discussions with a number of stakeholders who have engaged with the bank.

The Auditor General’s report states that 92 per cent of investees are small and medium-sized enterprises. On the face of it, that sounds quite positive, but that is not the same as 92 per cent of investments. Can you give me the figures on that latter point? How much money do you invest in small and medium-sized businesses in Scotland?

Al Denholm: I can take that one. You are correct: as of the last annual report date, 92 or 93 per cent of investees were small and medium-sized enterprises. I think that that comes out to be 59 per cent or 60 per cent of the investment in terms of pounds and pence. The reason for that is that some of those investments, such as the work at Ardersier, are bigger than others, which results in that tweaking.

Jamie Greene: I raise the issue because, when the Audit Scotland team presented evidence to us on the report, we heard that it had arisen in their feedback sessions with industry. One of the witnesses said:

> “I will highlight some feedback from the financial services sector that said that the bank could sometimes take more risks to support scalable businesses, particularly in the tech sector, to improve Scotland’s productivity.”—[*Official Report*, *Public Audit Committee*, 28 May 2025; c 12.]

Is that something that you would consider doing?

Willie Watt: Yes.

Jamie Greene: Good.

Willie Watt: On the point about SMEs, I should say that there are three criteria: turnover, number of employees and the capital that is invested in the business. It is on the criterion of capital that businesses sometimes fall down. For example, ZeroAvia, which produces hydrogen-powered aeroplane engines, has fewer than 250 employees and less than £40 million in revenue, but it has already had £150 million invested in it to get it to that point. XLCC, which is in your region, is in a similar position. It is still at an early stage, but the scale of investment that is required is what knocks it out. That is one of the reasons why our statistics are a bit different from what you might expect them to be.

Jamie Greene: Thank you.

The Convener: I have a couple of final questions to put to you. I will begin by tidying up a couple of issues that arose in the previous round of questions.

In response to the questions on remuneration arrangements, you mentioned that the remuneration committee had approved the long-term incentive plan and the mission contribution reward scheme. I presume that that also requires ministerial sign-off. Is that correct?

Willie Watt: Yes.

The Convener: I also want to ask about what, to me, sounded a bit like potential mission creep. My concept of the investment bank is that it is there to stimulate indigenous businesses and—I say this as a bit of a romantic—boost the manufacturing sector, which I think is important if we are to have a balanced economy. Can you take us through this whole thing about asset management? I am not asking you to repeat the answers that you gave to Colin Beattie, but I felt that, when you were talking about that, there could be a danger—perhaps not under your tenure, Mr Watt, nor under Mr Denholm's, but with the people coming after you—that some might see themselves more as asset managers than innovative state interventionist generators of local jobs, promoting manufacturing and so on. How do you ensure that the institution does not transform itself into a patient capital asset manager instead of being a nimble, fleet-of-foot and innovative stimulator of economic development?

Willie Watt: That is a good question. First of all, we are governed by the 2020 act, which is actually a pretty good document. It is quite clear and short, and it gives some protection against the risk that you have mentioned, as does the shareholder framework document.

However, for me, the key thing is that we are an impact investor. We were never asked to be an impact investor when we set the bank up, but we thought that it was the best way of dealing with the challenge that you have just set us. Being an impact investor means that, in every investment we look at, we look for social and environmental payback as well as commercial payback. That is hardwired into how every investment decision is made, and we are audited on that independently every couple of years through the operating principles for impact management, which are a United Nations standard approach that is applied to public and private sector impact investors.

We would always be an impact investor, and the capital that we would attract, perhaps from the private sector, would have to be impact capital; we would not accept capital from people who did not share our values. I think that that is hardwired into the bank's board and ethos, and I suppose that, over time, we have to be careful that, as management and boards change, we do not allow that to become diluted.

The Convener: Okay. You are leading me, inevitably, to questions about the Gresham House Forestry Fund, which was, for a while, the biggest investment that the Scottish National Investment Bank had made. Indeed, it went up to your £50 million limit. You might have heard me talk about this before, but when the investment in the Gresham House Forestry Fund was first announced, I looked at the basis of the fund, and it appeared to be less about saving the planet and planting trees than it was about helping wealthy people avoid paying tax. How do you respond to that?

Willie Watt: I respond by asking Al Denholm to answer the question.

Al Denholm: I will go back to first principles, if you like, by setting out what the Gresham House Forestry Fund actually is and separating it from any other elements that you might be referring to.

The fund was set up to invest in new woodland and forestry in the UK, but its focus is now on creating new woodland, which is a long-term strategy that I think everyone believes is important for net zero. When the fund was set up, we were a cornerstone investor of £50 million; it has now pulled in a total of £300 million—£299 million or so, according to the last annual report—of institutional money, including local government pension scheme money, predominantly. The premise of the bank crowding in £50 million to get £300 million of impact is important, and that is why we went in as a cornerstone investor.

11:15

It is also important to note that 85 per cent of that investment has gone into Scottish assets. I looked at the annual report: of the 59 woodlands that are in the portfolio, 49 are in Scotland. There is an immediate benefit to the Scottish forestry economy.

It is true that some investment frameworks that the Government has authorised, such as individual savings accounts and enterprise investment schemes, incentivise certain individuals to invest in it. Gresham is no different from any other investor in that regard. I stress that the vast majority of the assets, including local government pension schemes, are institutional.

The Convener: When the investment was announced, one eye-catching thing that we were told was that 60 per cent of it would be in Scotland, and the corollary of that is that 40 per cent would not be. Why is the Scottish National Investment Bank putting money into a fund that is not investing in Scotland?

Al Denholm: I repeat what I just said: about 85 per cent of Gresham's assets are now in Scotland. Eighty-five per cent of the £300 million being invested in Scotland is quite a big number. That is where the fund is at, based on its last annual report. It is beating the benchmark that was set out in its guidelines at the time of investing. It is finding that most of the opportunities to make investments are indeed in Scotland.

Willie Watt: We wrote into the agreement that Gresham had to invest more in Scotland than the £50 million that we had invested, so it would always invest more in Scotland than we had. In all our fund investments, we write in a condition that ensures that we get more investment in Scotland than our share.

Al Denholm: As part of our investment, one thing that we have ensured is that the fund acts as a responsible investor in Scotland when it comes to supporting the local community, providing public access, bringing communities with it and acting to the highest regulatory standards. We hold Gresham to account on those things.

Clearly, as an investor, we meet with all the investees that we invest in, so it is not a case of, "Here is a cheque—good luck." We regularly meet with the fund in order to ensure that it is acting in the way that we think is appropriate. As a senior investor—a major investor—we ensure that it is appropriately looking after our money.

The Convener: Okay, but is it appropriate—perhaps this is for you, Mr Watt—that public money is being invested in a venture that involves a partner whose principal purpose is to show people ways that they can avoid inheritance tax, corporation tax and capital gains tax and avoid paying into the public purse? Is there not any ethical consideration around such a decision?

Willie Watt: The tax-based schemes in forestry are set up by the Government as incentives to encourage more high-net-worth individuals to invest in forest assets. They are deliberately set up to give tax breaks for individuals to invest more in forestry because, at a policy level, somebody has decided that that is a good idea.

The particular fund that we invested in was not primarily about that at all, which is why the main investors are local authority pension funds. The main investors are the local authority employees of three or four midlands-based local authorities and the pension scheme of one of the UK's largest mutual banks. Gresham does a whole bunch of different things, some of which are tax based and some of which are not, but the forestry fund is not tax based. The fund is also regulated by the FCA and, if the FCA thought that it was not operating at the highest standards, its management team would be hauled over the coals.

The Convener: I am not really questioning whether it is legal; I am questioning the ethics of it.

I will move on. The other thing that has happened, subsequent to your decision to invest in it, is that the Gresham House Forestry Fund has been taken over by a New York-based private equity fund. You mentioned the covenants that you take out with investees to ensure that they retain their headquarters here. Gresham House was never headquartered here. It was previously headquartered in London, and it is now headquartered in New York. Ardersier port, which is another one of your maximum investments, is owned by an organisation that is headquartered in Houston, Texas. Are those matters any consideration of yours at all?

Willie Watt: Yes, they are. As I said earlier, the fund is managed by Gresham, but the governance is in the fund, so the new owners, whoever they might be, cannot impact anything about the fund—because it is governed by the fund governance. We are on the fund management committee, and we and the local authority pension schemes would certainly stop any drift in the policy of the fund.

Ardersier is a different matter. We are massively encouraged by the fact that an infrastructure fund would want to put £300 million into the decarbonisation of power in Scotland. The sums of money that are involved are so huge that we need to encourage inward investment by infrastructure funds. It helped us that it had made that quite big commitment of £300 million, because it made it easier for us and the National Wealth Fund to commit £50 million each. It is a commercial investor, but it sees offshore floating wind in the North Sea as a major investment opportunity. I want to see more of those kinds of investors coming in. We have to do our diligence properly: we have to ensure that they are bona fide people, that their funds have come from the right places and that they have the right track records. There are still risks associated with that, but I am broadly positive about those kinds of investors.

The Convener: I will turn to the other end of the scale and ask about one of your below-threshold investments, which was in a construction company that is building houses in Shetland for key workers, to try to address the housing shortage. The report about that enterprise mentions that it is in the process of converting to be—it may already now be—employee owned. On the point about ownership structure, what the company looks like, its governance and so on, was that a positive additional reason for making the investment?

Al Denholm: That is a fairly recent investment—from memory, it was £730,000—and, in effect, it is a loan to build six properties in Lerwick, where it is quite difficult to build affordable housing. The loan was to a company that has existed for a long time, which, as a result of the family's succession planning, wants to transition ownership to its employees, which I think is laudable. In due course, the loan will be repaid, the homes will go into other ownership, and the business will continue as a viable business. We hope that it will go on to build more properties. It is a multifaceted process.

We went below our normal £1 million minimum investment threshold on this one because the 2020 act includes additional elements about paying particular notice to more rural areas, such as the Highlands and Islands. It is unusual for us to go below our minimum threshold, but we felt that it was right to do so in this area, and we would do so again in similar rural areas if we felt that it was the right thing to do from an investment perspective. It has to be considered from an investment and local impact perspective.

The Convener: Is it fair for me to take from those answers that the employee ownership element did not play much of a part in the decision to invest?

Willie Watt: It was a positive.

Al Denholm: It was a positive, in that it meant that the company would continue to be a house builder in the local area, rather than stopping, laying people off and so on, as the owners retired. I think that the employee ownership element is a positive for long-term employment in the area and for the safeguarding of a business and part of the industry in the area.

Willie Watt: More generally, employee ownership is to be encouraged, because it is good from the point of view of aligning the workforce with the success of the organisation and its long-term nature. I have long been a supporter of employee ownership.

The Convener: Excellent. That is a very positive point.

I have one other question, and a couple of other members have quick final questions. My question goes back to the Audit Scotland report and its recommendation—which Mr Watt referred to at the very beginning of the meeting—that the bank should

“set out more clearly how it reaches specific investment decisions and the factors that have influenced its choice of investment.”

You have rehearsed that issue extensively during the course of this morning, not least in the answer that you have just given. How do you plan to go about doing that? How do you plan to be a bit more transparent than you have been?

Al Denholm: The first thing to do is to accept that finding, which was made by someone else who looked from the outside at what we were doing. It was very helpful to have that opinion voiced. We will take that on board and will proceed to do what we have been asked to do.

We have staff who are involved in our communication to all stakeholders. We put information on all our investments on our website. We will make sure that that information is more meaningful and will add in the aspects that were identified by the audit team.

I see that recommendation as a good piece of advice, which we will follow.

Willie Watt: We also have short videos that are accessible to people that we put on the website.

The Convener: That is great. Graham Simpson has a quick final question.

Graham Simpson: My question relates to third-party capital, which you discussed with Colin Beattie, and how to attract it. Do you see the bank becoming a fund manager that individuals and companies can invest in? There are a number of funds out there that invest in small companies in the UK. Do you see the bank being the kind of body that invests in small companies in Scotland that anyone could invest in?

Al Denholm: Our strategy is to align with like-minded institutional investors that want to make impactful investments in Scotland. In that respect, we are finding traction and a meeting of the minds.

We have something that is quite unique. We are a meaningful impact investor in Scotland. We have boots on the ground, we are well connected, we have expertise and we are building a track record. In my conversations with large institutional investors that have Scottish customers and a Scottish presence, I am finding that they are interested in aligning with us and doing something similar with their asset pool. That would be on an institution-to-institution basis, rather than a retail basis. I think that that is what you were asking about. Our clients would be large pension funds or large insurance funds, rather than individual investors.

Graham Simpson: So it would not be open to the public to—

Al Denholm: There is no reason why they could not do that, but they would do so through, say, an insurance company, which might have a pension or a fund that this could be a component part of. However, they would not have direct access to us, certainly in the medium term.

Willie Watt: The problems that Mr Beattie outlined earlier are much greater if you have private individuals investing, as opposed to the experts that Al Denholm mentioned. Interestingly enough, the Connecticut Green Bank has an annual open investment for all individuals in Connecticut. They can put money into an annual fund that is invested alongside the development bank's fund. That can happen with certain criteria, but it is a whole different ball game and it is much more complicated.

11:30

Al Denholm: It is a different set of regulatory hoops.

The Convener: We are not the Public Audit Committee for Connecticut, fortunately.

We will have one final and brief question from the deputy convener, before we wrap it up.

Jamie Greene: I have a follow-up from my last line of questioning. I know that you have a £1 million threshold, which you will go below in the right circumstances but, from a public relations point of view, if nothing else, would you consider opening seed funding opportunities at the sub-£1 million investment level if you could demonstrate that the successful applicants would be subject to further tiers of future investment as they grow? Alternatively, could you offer some sort of match funding opportunity? The big issue that is often highlighted in the feedback that we receive is that, as you say, grant funding is limited and is becoming more scarce, and private banks are saying no to higher-risk start-up seed funders. Is there an opportunity for SNIB to get involved at the lower end in the hope that those companies will scale up?

Willie Watt: That is a good question. Scottish Enterprise has a role in that marketplace, and we do not want to duplicate anything that it would do. It is possible that we could find an organisation that operates in the seed funding space and could operate a scheme on our behalf, so that we would not have to dole out the funding ourselves. We could also do that in decarbonisation, for example, where there are small organisations, such as farmers or individuals, who do not have access to capital to install heat pumps. It is possible that we could invest in other areas where we could disseminate smaller amounts of capital into the marketplace, but we have not found any yet.

Jamie Greene: If you had £5 million and gave £0.5 million each to 10 investments, over time, some of them would invariably do well. Surely, that is the whole point about growing the Scottish economy. If you are willing to pay a little bit of attention, you could play a vital role. The financial risk at that level would be small.

Willie Watt: Scottish Enterprise has a matched investment scheme that it runs with the angel networks, which is very much aimed at that area, and I think that it works pretty well. The risk would be that we might be competing with that, which could be a problem.

The Convener: I am reminded of the century-old question of the Macmillan gap and whether there is sufficient patient capital for the small and medium-sized enterprise sector, but that is a whole other discussion, which we do not have time for.

I thank Willie Watt and Al Denholm for their participation in the committee's work. It has been a long session, but we have found it productive, illuminating and valuable for the committee. There are a couple of areas that we might want to follow up on, but we will be in contact with you to remind you of those and to seek any further information. If we do not see you again, Mr Denholm, we wish you well for your long and prosperous retirement. You never know, we might see Mr Watt again before the parliamentary session finishes.

I close the public part of the meeting and move the committee into private session.

11:34

Meeting continued in private until 12:41.

This is the final edition of the *Official Report* of this meeting. It is part of the Scottish Parliament *Official Report* archive and has been sent for legal deposit.

Published in Edinburgh by the Scottish Parliamentary Corporate Body, the Scottish Parliament, Edinburgh, EH99 1SP

All documents are available on
the Scottish Parliament website at:

www.parliament.scot

Information on non-endorsed print suppliers
is available here:

www.parliament.scot/documents

For information on the Scottish Parliament contact
Public Information on:

Telephone: 0131 348 5000
Textphone: 0800 092 7100
Email: sp.info@parliament.scot

The Scottish Parliament
Pàrlamaid na h-Alba