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REVIEW OF THE EU FINANCIAL REGULATORY FRAMEWORK

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Witnesses: Mr Nicolas Véron and Professor Simon Gleeson

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Members present

Lord Harrison (Chairman)
Earl of Caithness
Lord Carter of Coles
Lord Davies of Stamford
Lord Dear
Lord Flight
Lord Hamilton of Epsom
Lord Kerr of Kinlochard
Lord Shutt of Greetland

Examination of Witnesses

Mr Nicolas Véron, Senior Fellow at Bruegel, Visiting Fellow at the Peterson Institute for International Economics, and **Professor Simon Gleeson**, Partner at Clifford Chance, London

Q45 The Chairman: Nicolas Véron and Simon Gleeson, you are both very welcome to our continuing investigation into the new framework. We will be very grateful to hear your answers to our questions. As ever with the House of Lords, we will send you the transcript of what takes place this morning. We ask you to check it to make sure that it is right and true, and we also ask you to remain on the qui vive so that if you think of any brilliant answers once you have left the room, you can send them to us—or, indeed, any updates as time moves on quickly in terms of the investigation. As I say, we will then ask for those to be corrected. We are being recorded and I should say to my colleagues to be aware of that. Any asides that are made need to have the guarantee of being very interesting, otherwise you should not make them at all.

Perhaps I could ask both of you for your overall assessment of what has been done in the reforms since 2008, whether you think they have restored financial stability, in particular whether you think the EU would be able to withstand a further asymmetric shock of any kind, and indeed whether we have sufficient flexibility built into the new framework that is

developing. We will go on to look at many other questions related to this. Professor Véron, perhaps you could respond to this first point.

Nicolas Véron: I am afraid it is a tiny point as we prepare for this session. I am not a professor, just Mr Véron.

The Chairman: I am always happy to elevate people, sometimes to the House of Lords.

Nicolas Véron: Thank you. A lot of things have happened. No two crises are identical, so we know that the crisis that has happened since 2007 will not happen again, and that would be the case even if the EU had taken absolutely no action in its wake. I think you are right to point to flexibility, and I suspect that we will come back to that. Let me say that obviously there is a need to distinguish between crisis management measures and regulatory and legislative measures that are more about building up a long-term framework and architecture. The two have come together, however, in what I see as the most significant development since the start of the crisis in 2007, which is banking union.

I will not go into a country-by-country analysis here, and obviously that will cause me to omit major developments that have taken place, not least in the UK. However, looking at it from the European perspective, banking union is the turning point both in terms of crisis management and the steps towards crisis resolution, which has not happened yet, and in terms of changes in the architecture of regulation and supervision. It is also about crisis management going forward with the resolution authorities. Why did banking union come only in mid-2012, some five years after the start of the crisis? It was because it was a difficult step to take.

The relationship between banks and nations is not only a vicious circle, it is a fundamental tenet of the way economic structures have been built up in European nations. In the past, banks were typically leveraged to finance wars, to finance government activity, and to

support industrial and economic development policies. The core of the French banking system arguably dates from Napoleon and his war effort. Similarly, Deutsche Bank was created under the aegis of Bismarck just after the Franco-Prussian war. There is an interconnectedness between banking structures and history and national structures and history that is very strong in Europe. What is therefore remarkable is not that banking union has come so late but that it has happened at all, given how difficult a political step it was for the countries concerned.

The reason it has happened, of course, is that there was no other option left between banking union and renouncing banking nationalism, and the break-up of the euro. It has taken time to come to that conclusion, which I think was correct at the time, and it is why the decision was made only in mid-2012. I will stop there with my introductory remarks because I want to be succinct, but I am sure that we will come back to some of these points.

Q46 The Chairman: Simon Gleeson, is it your appraisal that banking union is pivotal to that response, which is to serve to withstand asymmetric shocks and ensure flexibility of response?

Professor Simon Gleeson: That is a difficult question, so perhaps I may make three quick points. I cannot resist opening by saying that actually I am a professor—a visiting professor at the University of Edinburgh.

If you look at the totality of the European response to the crisis, with the exception of banking union—I will come back to that in a second—the Commission proudly announced that it had 40 different items of legislation. Of those, all of them, with the exception of one and the partial exception of another, follow policies that were already being implemented in the UK. Had Europe not existed, every single one of those directives would have been implemented here for exactly the same reasons that they were implemented at the

European level, because they were part of a globally considered response to the crisis. I do not think they preserve us from shocks generally. As measures, they were entirely effective in addressing the problems that gave rise to the last crisis and they do result in a more stable system.

Banking union is really nothing to do with the financial crisis as it was experienced. Banking union is to do with the European sovereign debt crisis. It is, exactly as Nicolas has said, an attempt to unknot the sovereign bank loop. The difficulty is that the only way you can unknot that loop is by creating a single European banking market. You may recall that that is what we are supposed to have been trying to do for the last 20 or 30 years. If banking union results in the creation of a genuinely pan-European banking system—and what I mean by that is a reasonably small number of banks which are present in a large number of European countries; in other words, something that looks a lot more like the banking system in the United States—we will have unknotted the sovereign bank link, and if we do not, we will not. What we have created is a regulatory change. We now have to wait and see whether that regulatory change provokes the change on the ground that is necessary to solve the problem.

The Chairman: Thank you for those three points.

Q47 Lord Carter of Coles: Well, Professor Gleeson and Mr Véron, I think that you have partly answered this in terms of banking union, but the question remains: what is the biggest achievement that has been made? What is probably a counterpart to that is the policy mistakes that have been made in the regulatory agenda. The second part of that question is: which elements of the reforms have been the most and the least effective in addressing the various issues? By those, I should like to look at consumer protection, market efficiency, transparency and integrity and, finally, financial stability.

Nicolas Véron: Policy mistakes—there have been so many that it is difficult to count them. Maybe I have a slight difference of perspective from Professor Gleeson on the analysis of the early years of the crisis, basically 2007 to 2010, where I would argue that having member states in an integrated or integrating market where there is competition on a cross-border basis, even while there is still a lot of fragmentation, provided the incentive for banking nationalism and thus supporting domestic banks at the expense of financial stability and prudence. This played a big role in the European crisis from the outset, not only in the eurozone but also in the UK.

I would argue that the UK has yielded to the temptation of supporting banking champions, including most visibly RBS in the run-up to the crisis, or at least to let them make mistakes. For example, it was a fact that RBS was allowed to bid for ABN AMRO in a consortium, and banking nationalism was a big part of that. I think that we are going back to the beginning of the crisis. Of course, the immediate follow-up question is whether the UK should turn to banking union, and this House has opined on that question at least by advocating flexibility and keeping doors open, which I think is very wise. However, that is not an issue for us today.

On the four or five categories you mentioned, consumer protection has been very absent from the agenda. Certainly at the European level, and again I am not entering into individual member states, not much has been done. As you know, there is an article in the treaties that was taken as the basis for the single supervisory mechanism which does not empower the ECB with a consumer protection mandate.

Consumer protection is emphatically not part of the banking union, at least in terms of the supervisory powers of the ECB, but I think we will have to come back to this because it is difficult to envisage a single market without some kind of common consumer protection.

Call me naive, but I think this is an area where in substance—I am not talking about the politics, obviously—the UK and its partners in Europe should be able to find common ground.

Market efficiency is the whole point of capital markets union. I suspect that we will come back to this so I will not dwell on it. Basically, what has been done is that some G20 initiatives have been implemented, particularly in the derivatives market, along with some other actions, most of which are minor. In derivatives, it is still very much a work in progress. For the sake of disclosure, I am an independent board member of the trade repository arm of DTCC, which is one of the players in the trade repositories market, so I might have an interest to declare. Most of the action is still to come, and that is integral to the buzzword of "capital markets union".

On transparency, I am optimistic that banking union will result in more transparency from banks. As Professor Gleeson reminded us, we have not seen proof of that—we can see the argument and the narrative but we still have to observe the outcomes. I am optimistic about those outcomes, although we may come back to this and it is true that it is too early to say for sure. Otherwise very little has been done on transparency.

On financial stability, again, no two crises are identical. It can be argued, I think convincingly, that while attempting to resolve this crisis and prevent it from happening again, we might have created opportunities in the EU for new forms of risk-taking that might come back to haunt us.

Lord Davies of Stamford: Such as what?

Nicolas Véron: There is a debate about shadow banking. Obviously Europe is very reliant on banks—this is also the case for the UK, it is not only on the Continent—for the financing of its economy. I for one believe that this reliance on banks is excessive and that new forms of

intermediation need to be developed. That is also part of the capital markets union agenda. However, it is also the case that in the same way as big risks have piled up in the banking system, new forms of risk will emerge in non-bank forms of financial intermediation, as we have seen in the US. Shadow banking, in a very simplistic depiction, has been a factor of instability in the US in a way that it has not in Europe.

Conversely, at a higher analytical level, the diversity of the US financial system has been a factor in resilience and stability in a way that we have not had in Europe because we were so dependent on banking. So assessments have to be nuanced on this, but obviously I am not downplaying the possibility of new forms of risk. That said, just to conclude on this, I see banking union already, and certainly going forward, in my cautiously optimistic outlook, as a very stabilising measure.

Q48 The Chairman: Before I come to Simon Gleeson, could you take a step back and say what you think are the two most important policy mistakes? You referred to a glut of them.

Nicolas Véron: I think that European policymakers have been very slow to reach an assessment of the crisis that would not be massively tainted by denial, blame-shifting and finger-pointing to outsiders. This has driven misguided reactions to the crisis from the beginning until now—for example, the current controversy about allowances in financial executives' pay. I am not saying that I am in favour of allowances, but this policy is certainly inspired by a misguided analytical basis.

You asked for specific mistakes. I think that the European member states went too far in extending guarantees to the banking system in late 2008—Ireland did, obviously, but so did the entire EU. There was a declaration on 16 October 2008 saying basically that banks would be guaranteed entirely, no matter what, under all circumstances. This was not framed as

temporary, and indeed this guarantee arguably lasted for the following four years, until 2012.

Then there was the second major mistake. It is very difficult to find a consensus view on what should have been done with Greece, but I think the Deauville declaration of October 2010 will remain a symbolic moment of the core member states of the eurozone removing any guarantee that was perceived before for the periphery countries, in a way that has created a lot of instability. It is a difficult area, and we may come back to it. Taken together, those two moments—guarantees on banks and the removal of sovereign guarantees—have proven to be a very combustible combination.

The Chairman: That is very helpful. Simon Gleeson, would you respond to Lord Carter's invitation and to those five areas that have been outlined?

Professor Simon Gleeson: Starting with the benefit to consumers, one of the most important things is that when we talk about consumers in this context we are talking about people who have to use the financial system whether they want to or not—savers, depositors and those who use cash payments systems. To that extent, when you ask the question, "What makes them best off?", the answer, boringly enough, is Basel III and Solvency II, the measures that require those institutions to hold more capital and make them more robust. What the consumer wants more than anything else is access to a working system tomorrow morning and confidence in it. Measures such as the bank resolution directive have the effect of making consumers better off in the sense that they are confident that they will get their money back if the bank fails, but that is not really their primary concern. The measures designed to increase the amount of capital in the system and stabilise it actually confer the primary benefit on consumers and, to some extent, corporations and other users of the financial system.

It is quite interesting to look at the question, “What are the most obvious mistakes?”. I want to go a lot more granular than M Véron and look at the lawmaking process. The three bits of law that you can most easily point to and say, “That’s bonkers” are the AIFMD, the hedge fund directive—

Lord Flight: Hear, hear. That is crackpot.

Professor Simon Gleeson: —the most recent round of persecution of the credit rating agencies, CRD III, and the bonus rules in the bank capital directive. What you notice is that all three of those were primarily politically driven. It is my view as a humble practitioner that populist politics very rarely results in first-class regulation. However, we would say that, shocking though it may be in this environment, populist political interference in policymaking is not unique to Europe; it occasionally happens in other legislative bodies, including possibly even this one. The strange thing is that when you look at that universe of obvious errors, what is interesting is what a relatively small percentage it is of the totality of what has been done.

There is a bigger error, which goes precisely to the point about the development of non-bank sources of financing, and I think there is broad agreement that that is essential for the development of the real economy, the thing we are actually concerned with here. The difficulty—and this points to one of the two really serious errors in policymaking in Brussels at the moment—is a failure to look in the round at the effect of the totality of what is being done as opposed to identifying individual measures.

It is absurd to say at one and the same time that it is a policy objective to improve the supply of money to the real economy through the shadow banking system and then to put in place a series of measures that hobble securitisation, make it harder to establish funds and increase the regulatory capital cost to banks of dealing with those funding entities. There is

nothing wrong with any of those policies individually but, taken collectively, they produce a system where you have one foot hard down on the accelerator and the other foot hard down on the brake.

It is true that this has been a period of hyperactivity in regulation. From time to time, it has been perfectly clear that all those involved—the Commission, the Parliament and for that matter the individual member states—seem almost to have run out of resources to deal with the number of things that have to be addressed at any given time. In a way, all that says is that we have a number of things that now need to be reviewed collectively because the important thing about them is not the impact piece by piece but the collective impact of everything that has been done.

The Chairman: Let us pass on to Lord Dear, who is exploring a very interesting area which is cognate to what you have just said.

Q49 Lord Dear: It is the question of effectiveness. It would help us enormously if you would comment on the effectiveness of the legislative process during the course of the financial crisis and which is still taking its own path at the moment. Which institutions in the EU were the most and least effective? That is a sort of shopping list, I suppose. In your view, was the financial regulatory process improved or weakened by the input of the Council and the European Parliament?

Professor Simon Gleeson: Our view—this is the perspective of those as it were in the greasy overalls with their hands on the nuts and bolts—is that the European Parliament has been a surprisingly effective vehicle for making a large number of small improvements to drafts. My view is that when the European Parliament does grand things collectively, they tend to be embarrassing or wrong, but when individual members take individual issues and push them, the result tends to be an improvement. It is hard to say but, on balance, my view is that the

European Parliament has contributed to significant improvements, certainly in some of the first drafts of legislation which have appeared over the years.

The Chairman: Do you attribute that partly to Sharon Bowles?

Professor Simon Gleeson: Yes. It is unfair to name any specific individual, but there are quite a number of MEPs who are very engaged and very happy to take individual points. Neither the Commission nor the Council can take a list of 450 minor amendments and push through all of them, but among the various available MEPs, that can be done.

Nicolas Véron: I agree with what Professor Gleeson said about Parliament. I do not think it is just Sharon Bowles. No disrespect to her, but it is much broader and something that is likely to stay after her. Irrespective of how the new chair of the Economic Committee plays out, we will see essentially the same form of constructive role of Parliament, at least on small things and incremental improvements, as Professor Gleeson just described.

In a way, it might be unfair to the Commission to say it, but the weak link of the past five years has been the Commission. I would not put that entirely on the shoulders of the Commissioner. I think the Commission has, to put it very bluntly, failed the test of the crisis in a way that the other institutions have not. It did not show an ability to analyse what was happening in a way that was helpful to the policy process in real time. I am thinking specifically of DG MARKT here—not the Commission generally, but the part that specialises in financial services. There is no blame for individuals, most of whom are very dedicated and competent; it is really more of an organisational failure.

It is a bit harsh on the Commission, but if you look at what has been produced in terms of regulatory and legislative initiatives over the past five years, roughly speaking you can map them in four blocks. One is the de Larosière report and its consequences. It was commissioned by Commission President Barroso with support from the Commission

Secretariat, but it was a high-level committee. It was mostly positive and implemented. The second is the G20 initiatives—Basel III, derivatives and the like. The third is banking union. In these three blocks, the origin is not DG MARKT. Then we look at the initiatives that came from DG MARKT, and they are the most questionable. Basically, the fourth block is mostly politically driven initiatives that do not make much sense or have much substance, and some of which were harmful.

On the other hand, Commissioner Barnier has been a powerhouse. He made things happen. He got legislation through. Sometimes it was almost too much. His famous colour-coded table of pieces of legislation gave the impression that the Commission was about quantity not quality, which was not necessarily the right signal to give, but credit has to be given to him because he made it happen. This powerhouse element has been important and broadly positive.

It is important to mention the ECB. The ECB has played an important advisory role, including on shaping some pieces of legislation, not least the single supervisory mechanism regulation. Its role has been broadly constructive.

The Chairman: Before I go on to Lord Hamilton, we will see Commissioner Barnier in two weeks' time. Is there anything in particular we should quiz him about? Simon Gleeson, do you want to mention the Commission, the ECB or the Council of Ministers?

Professor Simon Gleeson: There are two things, really. One is that one of the odder aspects of the way the Commission conducts itself is that when a particular part of it quintuples its workload, its staffing increases by zero, which is suboptimal, to put it at its mildest. One of the extraordinary things is that, despite what needed to be done, the amount of resource available for doing it changed not one iota. That really goes to the point about the effectiveness of the process.

The other thing comes back to something I should have mentioned in my initial answer about weaknesses in the process. To my mind, the biggest single weakness in the European process is the one we are about to encounter in this, which is that when a directive has been cooked, it is incredibly hard to go back into it and amend errors. We are finding drafting errors on a daily basis. That is not surprising. Given the sheer volume of legislation, it would be amazing if we did not. Some of them are minor, but some of them are potentially quite significant. None of them can be changed without another directive. If you travel back in time, this has been an issue ever since before de Larosière. It really goes back to the original CRD. The way this ought to work is that big policy should be made at the top level and implementation should be at a lower level. We still do not have a mechanism for correcting errors in the European legislative process that does not take five years.

The Chairman: That is fascinating. Before I go to Lord Hamilton, I shall ask Lord Kerr and then I will bring in Nicolas Véron.

Q50 Lord Kerr of Kinlochard: I am very interested in this point about coherence and the possible failure of the Commission, with individual bits perhaps making sense but with no overall overarching template. You cannot look to the Council to do that with its six-monthly processes. I was rather impressed by the arrival of the permanent President of the European Council and the way he tried to grip these issues early on, when there was still a lot of firefighting going on. I was more impressed by his paper, which was attempting an overall template, than by the Commission paper, where a whole lot of proposals for the fiscal, monetary, regulatory and governance development of the European Union, which had been knocking around in the Commission for years, were relabelled and issued as a programme. I thought that the Van Rompuy exercise was more impressive, more like what Delors would have done in the crisis than what the Commission actually did. I am not

concerned with Mr Barnier. I agree that he clearly gave great impetus to particular bits, but the point about overall coherence is a very strong point, which I would like to press a little further. Did the creation of the permanent President of the European Council and the presence of the first incumbent make any difference? Did it make the problems of incoherence worse or did it provide some palliative to the situation in the Commission which you described?

The Chairman: Nicolas Véron, you wanted to pick up something else that Simon Gleeson said. In response to Lord Kerr's last point, do you attribute it to being a personality-driven thing or was it the position that Herman Van Rompuy occupied that gave coherence to the whole?

Nicolas Véron: I was going to comment on exactly this, actually. The EU institutions are in flux, which is a major feature of the whole environment we are commenting on; we do not have the institutional stability that is taken for granted in every single western nation state. Because the institutions are in flux and constantly being renegotiated and transformed, it is very difficult to disentangle the individual element from the institutional element, especially in the question that you asked. On paper, it should be the Commission's job to bring that sense of consistency. It has not done a good job of it since the beginning of the crisis. I agree with you that President Van Rompuy has done a better job of it, especially in his important, agenda-setting paper of late June 2012 on the banking union, economic union, fiscal union and political repair. That clarified and gave a basis for analytical consensus on the narrative of the crisis. It was very constructive and adequate on substance. Credit has to go to him and his team on this, but I would be very guarded on whether this is a permanent feature of the institutional framework. Also, I think that the Commission can improve. It is not impossible

that the Commission will in the next five years do better than the one that we had over the last five years. Again, I make no particular attribution to individuals on this.

I wanted to respond to Professor Gleeson about this question of correcting legislation. It is a feature of legislation that only the legislator can correct legislation. If you compare this with the US, which is the obvious point of comparison, EU directives are easier to correct than Dodd-Frank. So in a way we have the advantage in this comparison. There is a big difference however in that there is much more in European legislation than there is in the equivalent US legislation, and there is more delegation to agencies in the United States than there is in Europe, for all the small print. I am cautiously optimistic about this as well. The creation of the European supervisory agencies, EBA, EIOPA and ESMA, and the banking union, will make us evolve towards a more US-like model, where Parliament will gradually, probably slowly, learn from its mistakes and the Council will learn from its mistakes—as well as the Commission learning from its mistakes, I hope—and we will have a more sensible division of labour between legislation and rule-making at the sub-legislative level. I do not expect this to happen quickly, but I think that we are broadly on the right path to correct that feature of our current process.

The Chairman: Simon Gleeson, could you respond to Lord Kerr—then we must rush on to Lord Hamilton?

Professor Simon Gleeson: All of this really comes down, I am afraid, to good old-fashioned institutional power politics. The reason why the Commission has not really taken account of the Van Rompuy output as it should have done is because it does not regard itself as subordinate to anyone, and certainly not to the Council. For the same reason, I think it is unlikely that we will see any divestment of power to the ESAs until the Commission is positively deprived of powers; it is most unlikely to give them up voluntarily and most

unlikely to abandon its stance that it is a legislator and a primary actor—and, if the Council disagrees with what it says, that can come out in trialogue. We have an almost complete centralisation of power in one entity at the moment and, unless there is a significant change to the constitution of Europe, which seems unlikely to happen, because it would probably require treaty amendment, we are probably stuck with that for the time being.

Q51 Lord Hamilton of Epsom: I would like to broaden the question on growth, which is a big problem for the eurozone at the moment. There is no growth in the eurozone while, in the short term, there is quite brisk growth in the United Kingdom. There are two drivers in the UK: one is the recovery of the financial sector and the other is this extraordinary growth in small businesses and self-employment, which has a lot to do with the lack of regulation or minimal regulation on small businesses. That goes back to previous Governments; I do not think that this one can take an awful lot of credit for it. Are there lessons to be learnt in the eurozone about the growth of small businesses in the UK?

Professor Simon Gleeson: I am afraid that I have to avoid macroeconomics due to having no major expertise. It is true that one thing that makes life harder as far as the financial architecture of Europe is concerned is that there is currently an absence of a European-level investment vehicle that is actually allowed to invest in small businesses. In many respects, one of the most useful things that Europe could do would be to get on and finish the European long-term investment fund legislative architecture, thereby providing a vehicle for that finance to flow. To be fair, what is happening here, viewed from the European level, is a tension between economic efficiency and investor protection. The idea that you should be allowed to sell to investors only something that invests in the shares of big listed companies is perfectly sensible if what you are looking at is protecting investors. It is not perfectly sensible if what you are looking at is trying to find ways in which to channel finance to small

businesses. It is quite right that the European banking system, given the regulatory architecture, is unlikely to be able to expand the flow of credit to European small businesses, so we need another piece of architecture. There is at least a proposal to provide one.

The Chairman: Nicolas Véron, could you respond to the growth agenda mentioned by Lord Hamilton. Lord Flight, could you make it brief?

Q52 Lord Flight: Very briefly, the French tax authorities came over here, looked at the EIS system, and put in an even more generous one in France. The amounts of high-risk capital raised for small businesses from the remaining wealthy French, given the tax rates, has been even greater than the EIS fund-raising here. So France has actually put in one mechanism to get risk capital for small businesses.

The Chairman: Nicolas Véron—the growth agenda.

Nicolas Véron: Sometimes France does something sensible; it does not happen very often, so let us celebrate. I am not sure that that is for the record. The question was about financial legislation and non-financial legislation; that is how I understood it. On non-financial legislation, I could not agree more. On the big opportunity for structural measures at this point, there is a very active debate in each of the member states on structural reform, and which structural reform each member state needs—for labour market reform, and the like.

The opportunity here is really single market reform. Single market reform, which was explored competently and appropriately in the report led by Mario Monti a few years ago, is really about harmonisation, but that means deregulation at home. This will happen only if individual member states—including perhaps the UK, where it might be easier because so much deregulation has already happened—say, "Whatever regulation there is in this area comes from the EU, not from us". It is basically unilateral disarmament, if you want to use that metaphor. There is a case for optimism because there is an alignment of governmental

strategies between Italy under Mr Renzi, France under Mr Valls, Germany and the UK, and also arguably Spain and others. There are fewer veto players among large member states against these single market agendas than there have been for as long as I can remember, so that is an opportunity.

Having said that, we should not underestimate the political difficulty of this stance of unilateral disarmament, which is basically about closing government departments that produce national legislation on these sorts of issues, sector by sector. It becomes very micro very quickly. I hope that there can be an agreement on this at EU level. I have not seen it yet. I see an opportunity. I see an opening. I hope it will materialise, but there is a lot of work to be done before it does.

On the financial aspect, I am of course for long-term investment, corporate loan securitisation, motherhood and apple pie. At this point, there is a consensus shaping up, even as, as Professor Gleeson reminded us, there is still cognitive dissonance about securitisation. I am afraid, however—and this brings us to the whole cluster of issues under the buzz-word umbrella of capital markets union—that there will be no easy fix that suddenly liberates the European financial system from its overreliance on banks. It is a long-term effort that goes across many different policy areas: securities regulation; investor protection and disclosure; prudential regulation; insolvency regulation, which is arguably the most difficult; tax, which is also difficult; and architecture, about the role of the supervisory authorities and what enforcement authority we'llgly have at the European level.

I briefly mention one example: accounting enforcement. I am not even talking about single-entity accounting. It is a well known fact that IFRS are not enforced consistently across Europe. We have full regulatory harmonisation with the IFRS regulation of 2002, but when you look at how it is implemented, we do not have the consistency to fulfil the promise. To

do that, you need a European chief accountant. I, for one, believe that this should be an agenda on which the UK and the continental nations could find common ground, but we do not have it at this point for a number of different reasons. Some are political, some are turf-related and some are private–interest reasons.

The Chairman: That is really helpful. I am anxious to pass on.

Q53 Earl of Caithness: Professor Gleeson, you have partly answered my question in responding to Lord Carter of Coles. As you rightly said, there are 40 different pieces of legislative enactment in recent years. Where are the contradictions, gaps and overlaps? What have these reforms done in the way of generating extra costs and inefficiencies in the financial sector? The third part of my question, therefore, is what are the unintended consequences of all this? Where has it led to extra costs, the transfer of risks off the balance sheet and that sort of thing?

Professor Simon Gleeson: We have talked about some of the individual instances. It might be helpful to talk about the biggest collective problem, which is not identifiable as any one directive but as an overarching point that goes across many of these 40. That is the fact that the European legislative process seems to have become somewhat disengaged from global consensus on a number of issues, and from a number of these areas in particular: derivatives, clearing and markets are obvious examples. We seem to be seeing an attempt not only to construct uniquely European solutions but to shut out the rest of the world as a result. This is what we call internally the Colditz problem—you start off trying to build a fortress but end up building a prison.

This matters in finance enormously to those countries which have significant cross-border financial business outside the European Union; specifically, this one. The issue in general is that the more you end up with quirky and slightly unique European approaches to particular

problems, the more you find yourself constructing obstacles to business between Europe as a whole and the rest of the world as a whole. Although I agree with everything M Véron says about the importance of developing the single market and creating more business within Europe, it is equally important for Europe to do more with the rest of the world. I would identify the biggest single problem coming out of the architecture of this as precisely the fact that a lot of it makes that harder.

Nicolas Véron: Two things. First, I agree: we can discuss why the EU has become much less of a champion of global standards and even on some aspects, such as Basel III, a laggard as opposed to the champion it was on Basel II. There is denial in Brussels but there is no denying that the EU has become much less exemplary in this global agenda since the beginning of the crisis. The first step towards redemption is to face this reality, analyse it properly and try to understand it—and then to try to overcome it. Like Professor Gleeson, I firmly believe that it is in the interest not only of the UK and individual member states but of the EU as a whole to be a champion of global financial standards and to have an open financial system.

One area for this is derivatives. Here I think the fault really lies with the G20. It was probably a good thing for the G20 to take action on the derivatives markets, but it was a really bad thing to take that action and prescribe a number of initiatives without creating a global process to make sure that these initiatives would be consistent. There are a lot of things happening in derivatives but there is no global standards-setter, at least not in the public sector, on what should be done. We therefore have very divergent legislation between Dodd-Frank, EMIR and initiatives still to come in Asia. Through my involvement with DTCC I discovered the ugly reality on the ground, which is much uglier than anything I suspected.

Back to your question about extra costs, gaps and overlaps and identifying them more specifically, if we want to go beyond our high-level discussion here, which admittedly is not very specific, there needs to be a lot of work. In the paper that Bruegel published last Thursday which I co-authored with my colleague Silvia Merler, we outlined an agenda for the next commissioner for financial services. One of the key recommendations is precisely to set up a process to identify these areas of overlap, gaps, unintended consequences and the like, and to go through a second round of repair, as Professor Gleeson suggested, in a structured way. It is a lot of work. It has to be done by a special committee, whatever the exact form. We suggest taking inspiration from the Vickers Independent Commission on Banking. Irrespective of what you think about the results, the process was very high quality. They did a very good job of analysing the substance and there is a lot to be learnt from that.

The Chairman: Nicolas Véron, we are very grateful for that paper giving advice to the future commissioner. Perhaps we could pass on to Lord Shutt.

Q54 Lord Shutt of Greetland: On that very point, I failed, I am afraid, in that I did not cope with it in 19 minutes. I felt that I had to read it again, but there we are. Coming on to the point that I want to ask, bearing in mind the work that has been centred on European banking union, market infrastructure and securities regulation, areas in which you are an expert, do you believe that there are particular regulatory risks here—and, indeed, are there remedial mechanisms in place to fine-tune the regulatory system where necessary without disrupting financial stability and predictability for financial users?

The Chairman: Professor Véron, you have identified European banking union as being critical. Would you like to respond to the question?

Nicolas Véron: Something I forgot to mention when I expressed optimism that we would have a better division of labour going forward between legislation and rule-making is

precisely the impact of banking union. The fact is that the ECB will become a very strong institution, much stronger than the ESAs, in producing or advising on rules, and I think that that will help the process. By the way, there was recently a very important ruling by the European Court of Justice—the UK against ESMA—which unfortunately the UK lost. The ruling clarifies the previous Meroni doctrine on what EU agencies can and cannot do. It gives them much more autonomy and the ability to delegate on matters where discretionary decisions are required than was thought to be possible before. At least, that is my understanding of the judgment. I think that it is a good thing and is exactly in the spirit of what Professor Gleeson said about having more of the detailed rule-making done at agency level; it makes it legally much more possible than it used to be.

Of course, I agree that the Commission has an incentive to retain its turf, but whether it will do so successfully in the way it currently thinks it can remains to be seen. I am slightly less deterministic than Professor Gleeson. Because of the heft of the ECB and possibly because of future reform of the ESAs themselves, we can look forward to a future in which more of the decision-making and rule-making will be done at the more competent agency level.

The Chairman: Simon Gleeson, would you like to add to that?

Professor Simon Gleeson: I am afraid that I reach exactly the opposite conclusion. We can look at the recent behaviour of the ESAs. While it is all very well for the European Court of Justice to say, "You can exercise your powers a little more broadly", we have a problem at the moment on the margining of uncleared derivatives. There is an error in the drafting of the relevant directive. The error is transparent and quite obvious on the face of the directive. ESMA is currently taking the view that it is absolutely bound by the words of the directive and is able to do nothing on its own initiative in order to correct this error. That is

precisely what causes the problem. It is an approach like that which basically makes these bodies really useless for amending and developing law and policy.

This is particularly alarming as we move towards MiFID, the markets directive, because market regulation above everything else is a process that involves a feedback loop. Although it would be much more efficient if a greater degree of power could be given to the ESAs, we have to accept that, first, it is not going to happen without some degree of constitutional change and, secondly, it would mean not just the European Parliament and the Commission, but also national parliaments effectively surrendering another wodge of powers over regulation in Europe. That is hard.

Nicolas Véron: I take a different perspective on this. After all, we are in the Houses of Parliament. The mistakes Parliament makes—this is also true for the EU institutions that make legislation—only Parliament can correct. There is a challenge to democratic processes and accountability if an agency that is less democratically accountable than the EU institutions themselves, including the European Parliament, is allowed to correct a material mistake that has been made in a piece of legislation. So I am tempted to say that the EU institutions should correct their legislation. The good news is that there are better and more flexible tools to do this than the US Congress has with Dodd-Frank, so I guess that this is all relative. I am optimistic looking forward. In future legislation I think that there will be more delegation to agencies, and that clarifies our difference of opinion.

The Chairman: We have some 20 minutes left.

Q55 Lord Kerr of Kinlochard: Perhaps I may test your optimism on another point. If you look at the scene now, there is no doubt that the European financial markets are much less integrated than they were six years ago. That is not the fault of the legislator, it is a consequence of the crisis. However, has the legislator done as much as it could to

reintegrate the markets? Let us take, say, banking resolution. The central common funds for dealing with a failing bank are minuscule and grow extraordinarily slowly. We will see for some considerable time to come banks renationalised in the sense that they will go back to within their national frontiers. Was that inevitable or is there something that could still be done? I am struck by M Véron's opening remarks about how we are seeing the end of national banking. It seems to me that we are miles away from genuine banking union.

The Chairman: Do you want to respond to that?

Nicolas Véron: Yes. The initial remark I made was definitely a forward observation. I was describing my expectation of what I am reasonably confident will happen rather than what has already happened. I think that banking union is the centrepiece of the EU effort to address market fragmentation, and so far what I am seeing on the ground makes me optimistic that it will work. At this point I cannot say that it has worked or even that it works because it is too early to tell. A timetable has been set and in barely more than a month's time we will have the results of the comprehensive assessment. They will give an early indication that goes beyond what we already know. I also suspect that in the second half of 2015 we will see the end of the wave of bank restructuring and recapitalisations immediately following the comprehensive assessment. I think that it will not be before the second half of 2015 that that particular cloud of dust will have settled. At that point we will know more about whether banking union does actually foster cross-border bank mergers and the sort of integration-friendly developments that the ECB says it wants to see. By the way, the ECB has been saying that very clearly.

The Chairman: Let us turn to Simon Gleeson. You responded very warmly to what Lord Kerr was asking.

Professor Simon Gleeson: To some extent, I think the question answers itself. The only thing that could be done was the establishment of a genuine, credible European bank resolution mechanism. On anything else, national Governments will take the view that if they allow their banks to become Europeanised, if the bank gets into trouble, the problem will fall back on them. The issue is that national Governments need to believe that the European resolution mechanism is credible, and to that extent, such a resolution mechanism would effectively have to be backed by the full faith and credit of all of the Governments of Europe. That is absolutely not the case. We have this, as you say, very small fund.

It is important to remember that Europeanising banks is harder than Europeanising almost any other sort of business. If you look at the experience of the new joiners, the Vienna initiatives and all the rest of that, Governments are very reluctant to give up control over their domestic banks. They are very reluctant to sign up to bailing out overseas depositors, and therefore they prefer to see their banks domestic. Short of the establishment of a credible European resolution mechanism and, I think, an accompanying prudential regulator, we will probably not make significant progress towards Europeanising banking. The question is one of credibility, and the credibility has to be with the treasuries of the member states concerned.

Nicolas Véron: I am aware that I probably sounded very Panglossian about all this, so let me agree with Professor Gleeson, but I would put it more starkly than he has. Basically, going beyond what has already been decided and is being implemented on banking union requires a further political step that was not made in mid-2012, which is significant progress towards fiscal policy integration. Essentially—again, to say it in simplistic and therefore slightly misleading terms—without fiscal union there is not much more you can do in terms of reintegrating the financial space than has already been done, at least in terms of banking. In

other words, the shortcomings of banking union and its incompleteness in its current form are essentially unavoidable unless there is further progress in fiscal and therefore political union.

My take on this is simply to say that monetary union with a sort of half-way banking union is much more robust than monetary union without banking union at all and it is much more supportive of an integrated financial system. I see the positive side of it, but you are right that we are not yet there. It is not realistic for the next year or two to go for fiscal union. I do not see it happening unless there is a major new development that is unexpected by at least most of us. It is possible to make progress on the whole capital markets union set of issues. This is where it is possible to take constructive action to make incremental progress and possibly some breakthroughs towards reintegrating, or fighting the disintegration, of the European financial space. Because EU capital markets are centred in London, it has to include the UK in a way that banking union did not, which makes it both a risk and an opportunity.

The Chairman: Let us pass on to Lord Flight.

Q56 Lord Flight: First of all, you did not mention collective or common insurance for the retail market, which I think is fundamental if you want retail bank Eurotisation. I shall ask about something we have partly touched on, which is the interaction between the EU and international regulations and standards. As a practitioner, I see this sort of ghastly thing on top of me. There is the FCA and the PRA gold-plating everything, there is stuff coming from Europe and on top of that, there is stuff coming internationally. America is perhaps the worst for over- and ridiculous regulation. We have FATCA and FATF. How do you see that interaction from the European point of view and how is what is going on from on high

internationally developing? Finally, and most importantly, there is Basel and banks. To what extent is Europe going to come in line with that?

Professor Simon Gleeson: The first thing to say about that is if you imagine that none of the international hierarchy existed at all and that we simply had the PRA and the FCA in the UK that were completely and unrestrictedly sovereign, the rules that would come out of that process would be almost the same as the ones we have today.

Lord Flight: I understand.

Professor Simon Gleeson: What happens above them is almost a policy-making process. One of the things you notice if you look at FSB/G20 level is that most of the policy input is coming from the UK and most of the rest is coming from the US—so, in a funny sort of way, we are making policy for ourselves through a very long and devious route. I entirely agree with your suggestion that the European Union is not as internationally minded as perhaps it could be. You are absolutely right that the United States is also not as internationally minded as it could be. Particularly if you look at derivatives clearing, one of the things that you notice is the ability to make large international disagreements out of microscopically small differences in policy and legislation. We must accept that some of these international conflicts are almost artificially created for political reasons. It is very hard to see how much of this would change if the international architecture was not there, save for the fact that international differences would potentially be even greater than they are at the moment, which would be detrimental.

Nicolas Véron: I have a different perspective. First, on the UK, it is natural that the nation that holds the world's most important international financial centre would be in favour of, would champion and would be a good practitioner of international financial policy co-ordination. I praise the UK for this. I am not surprised that this is the case.

The larger the polity and the more self-contained it is, which the UK certainly is not in financial matters, the more there is an incentive to go unilateral. I am not passing judgment on this but am describing what I think is almost a law of gravity in those matters.

Comparing the US and the EU, there has been a convergence in their positions. The EU has become much less internationalist by default than it was before the crisis. The main driver of this is the need to reregulate some market segments that came from the crisis experience. It is easier to be an internationalist when you deregulate. It is much more difficult to be an internationalist when you reregulate. The EU had to reregulate. It made being an internationalist more difficult. It is not the only driver, but it is the main driver. Conversely, I would argue that the US has become a bit less dreadful at this game and a bit more constructive in international financial policy-making. The contrast between Basel II and Basel III and what has happened with derivatives, warts and all, is testimony to this.

My third and final point is about the FSB. I entirely agree with Professor Gleeson that the degree of UK influence in the FSB at this point is extraordinary. I caution that this cannot last because it is just unsustainable. I think there will be debates about the accountability and representativeness of the FSB that will mechanically diminish UK influence in the FSB compared to its current level, for better or worse. It will be better in terms of legitimacy, and possibly worse in terms of quality of policy-making. That is a matter of judgment. One institution where this has happened, which is an interesting point of comparison for the shape of things to come, is the International Accounting Standards Board. The IASB was uniquely dominated by the UK in its early years, but is much less so now. It is much more legitimate and certainly more balanced in terms of geography. Insiders might judge that that has made the IASB a bit less faithful to its mandate in terms of quality of standards, but not to an extent that would dramatically compromise its mandate. There are compromises

to be made here. I suspect that this will be the direction of travel for the FSB, which is an important institution for future developments in the area you have asked about.

Q57 Lord Davies of Stamford: Do you agree that we have now achieved the right balance between the EU and national authorities in financial service regulation and supervision? I might just say to Professor Véron that I detected a certain contradiction in the paper he kindly submitted to the Committee, which he wrote jointly with Silvia Merler. You do not number your pages, which is not very kind to your readers, but on the fifth page you talk about banking union and so on and say: "The respective responsibilities of the ECB and national authorities … are subject to widely divergent insolvency frameworks … All regulated financial firms other than banks … remain supervised at national level … This creates scope for tensions, regulatory arbitrage and ultimately instability". You seem to be arguing that there is insufficient coherence, centralisation and uniformity.

Later on—again I do not have a page number but it is three pages from the end in the section headed "Crisis Management and Resolution"—you seem to be saying the exact opposite. In relation to proprietary trading and so forth, you say that we should, "leave to supervisors the intricacies of the implementation of this principle". If you leave to supervisors the intricacies of the implementation, you might be thought to be creating, in your words, "scope for tensions, regulatory arbitrage and ultimately instability". I see a certain tension in your article on this particular subject. I would be grateful if you could clarify what you really think about the right balance between EU supervision and member states supervision.

Nicolas Véron: Where you see tension I would argue that I and my co-author simply try not to have a one-size-fits-all approach. Depending on the issue at hand, the subsidiarity

principle, which I very much believe is a good organising principle for those issues, may give you different answers. At the current juncture—

Lord Davies of Stamford: The subsidiarity principle may indeed be in opposition to the right degree of supervision—

Nicolas Véron: No, the subsidiarity principle simply says that responsibility should be at the level where it is most effective. Basically, if things can be dealt with at the national level in an effective way then they should remain at national level. If they cannot, there is a case for bringing them to the European level. In the case of banking union there is a slightly hybrid level, the banking union area, which is likely to become larger than the eurozone very quickly but does not include the UK.

On structural separation, I reiterate my view that, at least for the time being, this is not a priority for legislation and therefore should be left for supervisors, which also means that inside the banking union area it will actually be consistent because it will be consistently implemented by the ECB as a supervisor. But I see scope for differences between the way it should be implemented by the Bank of England in the UK on the one hand and by the ECB in the banking union area on the other. I do not think that is a lethal infringement of the single market as things currently stand. However, I think there are other relevant areas here. You mentioned some of them; I mention also accounting enforcement. Possibly I would also add, and I have to work more on this, central counterparties, where a more consistent—and in many cases that means centralised—European and, in those cases, EU-wide as opposed to banking-union-area-wide delegation of authority would be advisable.

Lord Davies of Stamford: Is it not rather less than desirable that there is no general principle at all emerging from what you are recommending? What you are really saying is that there should be the right sort of balance structurally that makes most functional sense in each

individual case. Everyone would agree with that—it has always been the position that any sane person would take—but it does not really help you very much. It leads to a situation that is very opaque, confused and perplexing, both for the general public, obviously, but also for legislators and indeed for those who are themselves the subject of supervision and regulation, and inevitably leads to issues like regulatory arbitrage because it means that there are certain activities that can more profitably and easily be conducted in one part of the single market than in another, which is contrary to the whole principle of the single market. So your answer leaves me a little less than fully satisfied.

The Chairman: Before I ask Simon Gleeson to respond to that, I am going to ask Lord Dear to table his question, which I think is very germane to Lord Davies's point.

Q58 Lord Dear: It is a parallel point, really, about equivalence, the new rulebook, third-country actors and so on. In a nutshell, what risks do you see from multiple jurisdiction? Is there a danger of what we have put in the question as "multiple jeopardy"—a multiplicity of regulation across the EU and beyond? Are we being weighed down? This question has already been posed in some ways by Lord Flight. We are sitting here under a huge mass of sometimes competing regulations, and where the hell do we go out of all that?

Professor Simon Gleeson: The starting point is, obviously, that it depends. From the perspective of the participants in the market, their ideal situation will be to have a common set of rules across Europe that are enforced equally everywhere in Europe. Actually, the thing that creates the issue of multiple jeopardy is far more to do with the inconsistent enforcement of the rules that exist than it is to do with the rule-making process. In a way, we have sort of harmonised what we need to harmonise by way of rule-making; we really need to think much more about how we enforce what we already have.

Coming on to whether the balance is efficient, a good starting point would be that increased harmonisation is useful for activities that are inherently cross-border and less so otherwise. In the context of financial regulation, the specific point tends to be that retail savings products, for example, are sold very differently from country to country. An Italian saver buys an entirely different product in an entirely different way from a British or a German saver. It actually makes very little sense to harmonise the marketing of retail—

Lord Davies of Stamford: Ah, but if I could interrupt you, that distortion may be the result of different regulatory traditions and systems, and it may inhibit some savers in some countries from getting the products that would actually suit them best in terms of the risk-reward ratio, liquidity and so forth. That principle works against the economic advantages and the economic case for a single market.

Professor Simon Gleeson: Retail issues specifically are generally more to do with tax than anything else.

Lord Davies of Stamford: I am talking in retail terms. It may be to the advantage of someone living in Glasgow or Frankfurt that he would be able to buy and see marketed a product that currently circulates only in Italy. The whole point about single markets is to remove those kinds of barriers and anomalies.

Professor Simon Gleeson: That is entirely correct and I agree. However, if we go beyond saying that he should be able to buy the product and say, "And we will have a single standardised European disclosure document that describes it", what you are creating is something that may be instantly familiar to someone in Glasgow but is utterly incomprehensible to someone in Milan, just because that is not what he is used to. There is a question of whether standardisation at that level is entirely useful.

That is at the retail level. If we look at the wholesale level, we are trying to achieve a different thing. The easiest way of putting this is to say that if London, for example, wants to be the European financial centre, Europe must feel that it is able to regulate it effectively. It goes beyond the question of how we generate the best regulation towards how we generate the regulation that allows this entity to perform the job that it wants to in the legal context in which it needs to perform it. It is not simply a matter of saying who is technically the best regulator; you are saying, "Who needs to feel that they have a hand in the regulation of this thing?". To that extent, I would argue that the balance is wrong. We still do not have sufficient European control of the City of London to leave other European Governments happy with the fact that increasingly Europe has only one financial centre, and that is it.

Nicolas Véron: I entirely agree with what Simon Gleeson has just said. It is probably easier for a continental such as me to say than for a UK citizen like him, but we are on the same page here. My way of putting it is that the City of London has this outfit that deals with policy issues called TheCityUK and it is high time for it also to think of having "TheCityEU", not necessarily superseding TheCityUK but certainly existing alongside it. Of course that is just about labelling; more to the substance, I do not think it is possible, with the current state of Europe, to have an extremist view that would say that financial policy is entirely national or entirely European. Maybe one of those two might be desirable but I do not believe it is, and I certainly do not believe it is realistic. Therefore we are in a hybrid—some would say federal—framework where some aspects are national and some are European, and it is appropriate that the subsidiarity principle should guide policymakers in determining what is national and what is European. If it is complex, so are all federations.

Q59 Lord Davies of Stamford: Are you confident that in practical terms you will be able to get a consensus as to the right subsidiarity answer and where the best level of regulation is

in terms of functionality? There is not necessarily an indisputably obvious solution in each particular case.

Nicolas Véron: That is true, and this is why all federations that I know are a constantly renegotiated arrangement where nothing is really in a steady state. You see that in the US, in Switzerland and in all federal organisations. That brings complexity but it might be better than the alternatives. On the assessment of what is sufficiently consistent and what is not, I also express my full agreement with Professor Simon Gleeson; enforcement is where the biggest problems are. That is not to say that there are none regarding the harmonisation of legislation, but there are many more in terms of enforcement. I mentioned accounting enforcement but I would also mention single-market enforcement. When you discuss with people inside the Commission's internal market directorate, all those who I know agree privately that the European Commission has not done enough by a mile to enforce single-market legislation. It goes beyond Mr. Barnier.

Lord Davies of Stamford: Is that not a reflection of the fact that it is local national authorities that tend to be responsible for enforcement?

Nicolas Véron: The European Commission has enforcement powers that it has not used to the extent that it should have; that is the assessment that they make, and I fully share it. Again, contrasting banking union with capital markets union, there is a bit of a paradox. As Simon Gleeson said, wholesale markets should be more integrated than retail markets, but with banking union we have segments of retail markets that are now more integrated than wholesale markets. There will be catch-up action here. Again, I give the example of accounting and auditing, which should be relatively uncontroversial, even though there are enormous vested interests. The ECB as a supervisor will supervise banks whose national operations are audited by fully independent national firms; of course, they are part of a

network, but we know that these networks are not centrally integrated. Those national auditors are regulated by national audit regulators that are themselves independent from each other. This is a recipe for inconsistency of accounting practices, which will quickly become unworkable for the supervisor. So of necessity we will see evolution in that area.

The Chairman: Let us move on to our final subject. As a coda, I will say that we sit here in a legislative assembly, or Parliament, and I am often conscious that as Members of Parliament we are very happy making laws. Where we fall down so often is in monitoring and enforcing the very laws that we have created. Let us pass on to our final subject, and Lord Kerr.

Lord Kerr of Kinlochard: This is the painful bit, where our witnesses are playing on our schizophrenia. Professor Gleeson says that if London is to remain Europe's financial centre, Europe must feel that it can effectively regulate it. Sell that in the Palace of Westminster!

Lord Flight: Sell that to the City of London!

Lord Kerr of Kinlochard: What is the deduction that one can draw from how the banking union has been handled by the British Government as something completely separate from the single market? We are distinguishing clearly between the single market, where we wish to see it deepen, and banking union, which is a matter for eurozone countries. The Poles and Swedes can stand around as members if they like, but it is nothing to do with us. On the other hand, by God, if banking union starts feeling that it deserves its own financial centre as a rival to London, it is an appalling attack on the Ark of the Covenant. Have we played something wrong? Was that all inevitable, or did something go wrong in the British approach?

The Chairman: I am going to ask Lord Flight to add his question and then ask our two witnesses to take deep breaths and reply to the composite question.

Q60 Lord Flight: The question is whether the UK has done enough to protect its national interests. My background points would be varied. One is, as Professor Gleeson has already highlighted, we started off with AIFMD, which was crackpot. It is questionable whether it has done anything for hedge funds but, by attacking every other fund with these ridiculous requirements, it has infuriated practitioners across the board. Certainly, on your comment about how London must be regulated by the EU—pull the other one. Of course, 70% of London's business is not EU anyway, so there is a logic for all that other business. Professor Gleeson has broadly said that it would have been much the same anyway, if the UK had done it. I partly agree, but there are things in MiFID that we certainly would not have done and which are a damned nuisance. MiFID 2 may be protectionist—and I think that we made reference to that. AIFMD is a damned nuisance. So we have all of that where we have not protected ourselves and where Europe has got it wrong as well.

The Chairman: Simon Gleeson, would you care to reply to those questions and take the opportunity to add anything, if you think that there is anything that we have not heard said this morning that is urgent to our report.

Professor Simon Gleeson: Gosh, this is hard. Starting with Lord Flight's point, the UK occasionally finds itself in the most terrifying bind, when it is faced between doing what Europe says should be done and doing what would be most efficient and effective as a regulatory measure. That happens from time to time. It happens in every country with every European measure from time to time. At the end of the day, the question is really very simple: to what extent are we prepared to endanger our position, whatever it is, with regard to whatever else is going on?

The answer to Lord Kerr's point on what went wrong can be very simply summarised. There was an extraordinary UK disengagement at the policy level at a sufficiently early stage. It is

my personal opinion that certain UK Government departments, particularly the Treasury, proceeded for far too long under the illusion that they were sovereign law-makers when in fact they were not. Over the last seven years, we have seen a rather violent correction of that illusion. In order to correct that, it is necessary for those who make financial policy in the UK to be clearly aware that financial policy is no longer made in Horse Guards Parade—it is made in Brussels—and to manage the making of policy on that basis.

The Chairman: Before I bring in Nicolas Véron, the Earl of Caithness has a short question.

Q61 Earl of Caithness: In your paper, under single market integrity, you advised the new Commissioner to "avoid the twin risks of discrimination and special favours". Have there been any risks of discrimination and special favours in the last 40 lots of enactments against the UK and non-eurozone countries?

The Chairman: Would you like to respond to that but also to the following question? As an outsider, could you help us with the United Kingdom's engagement or otherwise with the European Union?

Nicolas Véron: On that last point, I think generally anti-finance legislation tends to be anti-UK, because that is where most of the finance is, or at least wholesale finance. So there has been some discrimination I guess, and traders' remuneration is a good example of that. De facto it is a bit of an anti-UK thing, even though that might not have been the primary driver. Who knows? It depends on who you are talking about. As for special favours, there is a very good case of one in M. Barnier's proposal for structural separation, published last January, where the Commission's legal service has said that to give a free pass to Vickers is not consistent with the fact that this is a regulation not a directive. That is the sort of thing that I had in mind when drafting this jointly with my co-author.

On the broader question about EU legislation, again, I want to see the bright side. The EU process can improve and the UK help to improve the EU process. The UK was instrumental when the Commission was committed to better regulation processes. There has been a pause in better regulation but there is no necessity that better regulation cannot come back. I can only agree with Simon Gleeson that the isolation of the UK from the EU policy process is very bad from that perspective, because we lose an important force to push for better regulation.

On the big question of national interests, I see basically three different sets of interests. Of course, the reality is much more complex, but let us simplify it for the sake of argument. There is the turf interest of the UK government institutions, including Parliament but also the Treasury, the Government and agencies such as the Bank of England—that is number one. Number two is the interest of the City, which can probably be proxied by the increase of wealth of all the people who work there. Number three is the interest of the UK as a nation, which is the common interest of all its inhabitants and citizens. Depending on which of those three sets of interests you want to maximise or optimise, you get different outcomes.

What is clear to me at this juncture is that the City's interest and the turf interest of the UK Government are more divergent than at any time I can remember. I have not been there very long, but long enough to say that they are particularly divergent at this point. There is an interesting question about where the national interest of the UK is in this tussle. I instinctively see that this points more to the City's side than to the turf interest of the UK government side in our debate, which is where the locus of regulation should be, in the way that Professor Gleeson has framed it. That is a very difficult situation to be in. It is not easy,

so I have sympathy for my friends in the UK in all parts of society and government who struggle with it.

Capital markets union—to use again the moniker that Jean-Claude Juncker has introduced—is a test of this. Can we find a positive agenda where the interests of the UK, those of other European countries, the common EU interest and the interest of the City of London are sufficiently aligned so that significant progress can be made towards more integrated capital markets, with appropriate enforcement, monitoring and supervisory mechanisms? I believe that it is possible. I see the UK government authorities, including but not only the Treasury, being tempted to stonewall and say, "Well, of course we love capital markets union; it should be an amendment to the directive on prospectus and some new legislative text on securitisation which will not have much substance", which is another way of saying, "Let's say we love capital markets union and do nothing on capital markets union, or so little that it will not make any difference". I am not sure that this strategy—if it is a strategy—is aligned with the UK national interest. I cannot opine on the politics of it, not being a UK citizen myself, but I can certainly say on policy that I see much more scope on substance for a constructive agenda of capital markets union where the interests of the UK as a nation, of London as a financial centre and of the EU as a whole are broadly aligned. I hope this will materialise. I am not sure that it will.

The Chairman: Simon Gleeson, Nicolas Véron, thank you very much indeed for coming before us this morning and for your excellent testimony—and for avoiding any reference to the Scottish referendum!

Nicolas Véron: We said the UK!

The Chairman: As I indicated before, we will send you a transcript of our conversation. Please improve it; please add to it if you have any further thoughts. But you can tell by the

reaction of my colleagues that this has been a very invigorating hour and a half, and we are most grateful to you both for coming in and starting our “September Song”.