



Financial Services Regulation Committee

Corrected oral evidence: Growth of private markets in the UK following reforms introduced after 2008

Wednesday 23 July 2025

10.05 am

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Members present: Lord Forsyth of Drumlean (The Chair); Baroness Bowles of Berkhamsted; Baroness Donaghy; Lord Hill of Oareford; Lord Hollick; Lord Lilley; Baroness Noakes; Lord Sharkey; Lord Vaux of Harrowden.

Evidence Session No. 3

Heard in Public

Questions 30 – 38

Witness

I: Nicolas Véron, Senior Fellow at Bruegel and Senior Fellow at the Peterson Institute for International Economics (PIIE).

USE OF THE TRANSCRIPT

1. This is a corrected transcript of evidence taken in public and webcast on www.parliamentlive.tv.

Examination of witness

Nicolas Véron.

Q30 The Chair: Welcome to today's meeting, which is the third oral evidence session in the committee's inquiry into the growth of private markets in the UK following reforms introduced after 2008. Thank you, Monsieur Véron, for attending. A verbatim transcript will be taken of the evidence and will be put on the parliamentary website. A few days after this session, you will be sent a copy of the transcript to check it for accuracy. It would be helpful if you could advise us of any corrections as quickly as possible. If, after this evidence session, you wish to clarify or amplify any points made during your evidence, or have additional points to make, you are very welcome to submit supplementary written evidence to us. Do you want to make a short opening statement?

Nicolas Véron: Thank you very much for the invitation to participate. It is an honour and a privilege. As you know, I work for two organisations: Bruegel in Brussels and the Peterson Institute for International Economics in Washington DC. I should disclose for this session that I have also been for many years a non-executive independent director of the trade repository arm of DTCC, which is a piece of financial infrastructure that collects information principally about derivatives transactions. It has an entity in the UK, which is regulated by the FCA. I am also an investor in venture capital funds managed by a firm led by my brother. I have most of my savings in those funds, so that may be relevant to our discussion. Even so, I do not think it creates a conflict of interest. As for Bruegel and the Peterson Institute, they have many stakeholders in the UK, including private companies and firms. In addition, Bruegel is specifically supported financially by the UK Government and the Bank of England.

I work mostly on financial services—probably more in the EU than in the US, and more in the US than in the UK. I try to get a global comparative perspective on things. I view myself as a generalist. I am not an equity analyst or a bank capital professional. You could call me something like an enthusiastic bank capital amateur. So that is by way of background.

The Chair: Thank you for that. The first question is a general one. How does the approach taken to the implementation of the Basel standards in the EU differ from the approach taken in the UK? What are the effects of EU bank capital and other regulatory requirements on the growth of non-bank financial intermediaries, in particular private credit? Does the differential treatment between large and regional, community or smaller banks in the implementation of the Basel standards in the EU and, for example, in the US influence access to credit by small and medium-sized enterprises?

Nicolas Véron: These are vast issues. I will try to be succinct and we can follow up on any point you may wish to drill down on. Obviously, the implementation of Basel III, up to and not including the so-called Basel III endgame, had been the same in the EU and the UK initially. That was the successive capital requirements regulations, starting with those

adopted in 2013. There is a lot of similarity in Basel implementation between the EU and the UK.

There has been recent divergence, which is an inevitable consequence of Brexit. The UK, as you know, has delayed its adoption of Basel III more than the EU. Also, the UK is going towards a more differentiated approach, depending on the size of banks, than the long-standing practice of the EU, which is to apply the same capital regulations to all banks, irrespective of size. You mentioned the even bigger difference with the US, where Basel, strictly speaking, is applied only to G-SIBs, the global systemically important banks, while even large regional banks such as Silicon Valley Bank—until its demise—are not really subject to the Basel requirements. Even so, there is a certain gradation of supervisory requirements for medium-sized banks.

It is difficult to say how that affects behaviour. As you know, in that area, tracing the economic impact of regulation can be difficult, even ex post and even more so ex ante. In general, to the best of my knowledge, there is no evidence of scarcity of credit in the EU, the UK or the US. At this point, credit is abundant. That is a feeling in the banking community in all three jurisdictions. Even though bankers may say the opposite in public language—should capital requirements be eased, that would probably have to go into bigger dividends or buybacks for shareholders, given the lack of obvious unmet demand for credit from the real economy.

Of course, this assessment is a bit too sweeping. It should be nuanced depending on which segments we are talking about and which capital requirements apply to different business and lending segments. But the general picture—this is important for our discussion—is one of no scarcity of credit, and certainly no credit crunch, in the current circumstances.

The Chair: We have heard that private credit in the United Kingdom is increasingly competing with banking to provide corporate lending, whereas we understand that the private credit market in the EU is smaller, suggesting that the banks remain relatively competitive. Do you agree with that? Are banks in the EU better able to compete with private credit in the provision of finance in comparison to the UK? To what extent is that driven by differences in regulation?

Nicolas Véron: It is a difficult question. I have not done in-depth work on this area, so I will not pretend to know more than I do.

The structures for private credit investment may be more mature in the UK than in the EU, so it could be that there is a space for the expansion of private credit in the EU that has not been filled by market forces, if you will. The picture in the EU is very differentiated. Private credit developed early in the Nordics, for example. I assume, but I did not check, that in the Nordics, which are part of the EU—leaving aside Norway, which is part of the single market—the levels of private credit development are similar to, if not higher than, what they are in the UK.

You also have to take into account the obvious differences in size and structure of the EU as compared to the UK. A big part of the UK is the major financial centre of London, which cannot be extrapolated to the EU as a whole, so I would be cautious in making a comparative assessment.

I do not think that there are huge regulatory differences. Where there might be differences is in the broader environment. For example, the court system is very important for private credit. The quality of the UK justice system may positively affect the development of private credit compared to vast segments of the European Union—including in southern and eastern Europe—without differences in financial regulation affecting those outcomes to a similar degree.

There are also issues of corporate governance. Labour legislation plays a big role in this area, as it does in venture capital. The ability to hire and fire is very important for private credit investors. So I would make a holistic assessment on your question and not reduce it to differences in financial regulation in a strict sense.

The Chair: Thank you for that comprehensive answer on something you said you had not thought very carefully about; it was very helpful.

Q31 **Lord Sharkey:** I would like to ask about the interconnections between banking and private markets. How prevalent are the interconnections between the banking sectors in the EU and the United States and the global private credit market? Which segments of the banking sector are connected to global private markets?

Nicolas Véron: I do not know. I would assume that there is more such interconnectedness among larger banks than among smaller banks, but there might be exceptions that I am not aware of.

There is specialisation in those markets, so it might be that, in the different jurisdictions you mentioned, a very limited number of banks have exposure to the private credit market. I cannot tell you which ones as I have not looked at that information; I do not know to what extent such information is easily accessible in the public domain. What I do know for sure is that, in recent years—probably the last five years, if not more—supervisors have paid a lot of attention to this matter. Private credit is high on the supervisory radar in the US, the UK and the EU. This is not a neglected part of the risk landscape. Recent and long-standing experience has shown that crises tend to appear first in neglected segments of the supervisory radar, as a matter of general correlation.

Having said that, this is not to say that there is nothing to worry about in terms of banks' exposure to the private credit sector. Here I view the US differently from the EU and the UK. The quality of banking supervision in the EU and the UK is generally quite high, as a matter of first-order consideration. We may come back to this. It is about as high in the UK as it is in the eurozone—maybe with a differentiation for the non-eurozone EU countries, but these are quite small in banking terms. The quality of banking supervision in the UK, the eurozone and non-eurozone

jurisdictions such as Sweden and Denmark strikes me as higher than in the US and as having been so for some time.

If you want to drill down into this issue, it would be useful for you to look back at the lessons from the Silicon Valley Bank/regional bank crisis of March 2023, which, in my view, has exposed a significant gap in the quality and effectiveness of prudential supervision between the US on the one hand and the UK and the eurozone on the other. I am pretty sure that that gap has not been corrected; if anything, it is going to increase in the foreseeable future, given the difference in policy directions.

Lord Sharkey: It would be useful if you could point us in the direction of some literature on the gap you have just been talking about—not now, necessarily.

Nicolas Véron: I can give a brief answer on that. I am not aware of any good literature on this; it is based on my personal research, analysis and judgment.

Supervisory effectiveness and performance are notoriously difficult to assess; basically, they get exposed when there is a crisis. We learned a lot about the gaps in US supervisory effectiveness during the 2023 crisis. There is a very good testimony—I will submit it after this session—by a person named Newell, I think, who used to work in the Federal Reserve system but left it before the 2023 crisis. It is dedicated mainly to this issue, as I said, but it does not go into comparative analysis of the UK or the EU—or the eurozone, for that matter.

It is a tragedy that the lessons from the 2023 crisis, which was quite severe—it was a systemic banking crisis even though it lasted very briefly in the US—have not, to my knowledge, translated into any policy changes. To the extent that there were organisational changes, for example in the Fed system, I assume that they have been reversed or will be reversed in short order. That is not reassuring.

I should add that, with the possible exception of the OCC—the Office of the Comptroller of the Currency—all banking supervisors had, if you will pardon my French, egg on their face during the 2023 crisis. That includes the Fed—not only the San Francisco Fed but the board of the Federal Reserve—the FDIC and the state authorities, at least in California and, I think, in New York.

Lord Sharkey: You described this as a systemic crisis.

Nicolas Véron: Yes, but that is not an original way of describing it. The March 2023 crisis has widely been described as systemic by American scholars and some observers from the supervisory community, at least in private. The crisis was very intense. The systemic risk exemption was triggered, as you know; that is the hallmark of a systemic crisis. It doused the fire very quickly. You will remember that it took a few weeks to address the situation at First Republic, but there was no turmoil after a weekend of crisis management.

That said, it was systemic in nature. As you know, it also affected very large banks that failed in the circumstances or were dechartered; from a historical perspective, even adjusting for inflation, they were among the largest in US banking history.

Lord Sharkey: Can I ask you a little more about the banks in the EU and the US? We have heard evidence that these banks are establishing joint ventures with private credit funds. Are these trends present in the EU and the US? If they are, how prevalent are they, and what is driving that?

Nicolas Véron: I have not looked at this in detail. I would not be surprised to see the same kind of joint venture or partnering from eurozone or US banks—probably more from G-SIBs than from any other segment of the banking industry—and maybe from some medium-sized banks in both the US and the eurozone. However, I have not looked at that in any detail, so I cannot describe the kinds of transaction that have been considered or implemented.

Lord Sharkey: Is it the case that, for example, the banking sector is increasingly interconnected to private credit markets in the US and the EU?

Nicolas Véron: The private credit business model has been changing. To my knowledge, it increasingly includes elements of leverage and connection with the insurance sector. That should perhaps be more of a direct concern—in the first order of magnitude, at least—than the connection with the banking sector.

Lord Sharkey: Can you elaborate slightly on your comments about the insurance sector?

Nicolas Véron: Basically, private credit groups in the US have established insurance affiliates—life insurance affiliates mostly. Apollo comes to mind for that practice; it has started to export this model, which could be viewed as regulatory optimisation, if not arbitrage. Those life insurance affiliates are big investors in private credit activity.

I do not know whether you watched last week's speech and Q&A from Michael Barr, the governor of the Federal Reserve system, at Brookings in Washington DC. The speech was all backward-looking on the lessons from three episodes of deregulation and crisis in the US, but it was obvious that it was intended to apply both to the current situation in the US and to risks going forward. If you listen to the Q&A, which was brilliantly managed by David Wessel of the Brookings Institution, you will hear a lot of information on the Fed's current assessment of the financial risk built up in the US, including in private credit; I think that there were one or two questions and answers from Michael Barr on this issue. That is my most current knowledge of the US situation. He emphasised this linkage to insurance in a way that I found very clear.

Lord Sharkey: Do you have any general comments about the implications of interconnections between banks and private credit, as well

as between financial stability and growth?

Nicolas Véron: He said that supervisors have their eyes on this issue and have had for several years. Given that I assess the quality of prudential supervision in both the UK and the EU—if not in the US—as quite high, I am not overly concerned by the build-up of exposures. It is probably going upwards not downwards in the eurozone and the UK. I say “the eurozone” rather than “the EU” because I have not worked in detail on the non-eurozone countries.

Again, to give an order of magnitude, eurozone banking assets are a bit more than 90% of EU banking assets, so the bulk of the EU banking sector is in the eurozone under the practical supervision of the ECB within the framework of European banking supervision—the single supervisory mechanism. In that context, I would not think of this as a major concern that might have escaped the attention of supervisors in the eurozone and the UK. I would not say the same about the US because of the systemic flaws in the performance of prudential supervision that we observed in 2023; as I said, I do not think that those gaps have been corrected.

Q32 **Lord Hollick:** Staying with the question of interconnectedness, are you satisfied that there is sufficient data and information on the secondary market? In the interestingly titled book that you co-authored, *Smoke and Mirrors, Inc: Accounting for Capitalism*, you draw attention to the rather creative nature of the information that is available on the secondary finance market and the dangers in the information that is provided. How do we tackle getting sufficient information on the secondary finance markets given their accounting practices, which you explained carefully and rather colourfully in your book, to make sure that they are adequately regulated?

Nicolas Véron: I thank you for mentioning the book that I co-authored with Matthieu Autret and Alfred Galichon, but it was published 20 years ago and written more than 20 years ago, so I would not take it as current analysis. Even so, the intention of the book was to describe the timeless practices of accounting shenanigans.

There are several levels of information here. There is accounting information on the financial statements of banks and other financial and non-financial firms. There is supervisory information, which is accessible to supervisors but not to the public, particularly on banks’ exposures. There is the so-called Basel pillar 3 information, which is information that banks have to disclose beyond the applicable accounting and financial reporting requirements under the so-called transparency pillar or market discipline pillar of the Basel framework. This pillar 3 information has traditionally been of very variable quality, but there has been an enhancement of the pillar 3 disclosures, standards or guidelines, both from the Basel committee in general and in the European context more generally. So there have been some improvements. Having said that, the short answer to your question is that this remains an area that is not very well covered by public disclosure requirements.

I am not sure I can say the same about supervisory disclosure requirements, which, as I said, are non-public. Information is available to supervisors on a jurisdiction-by-jurisdiction basis, but not available in the public space. It is very difficult for me to assess the quality of those supervisory information flows, because I am not a supervisor and therefore I do not have access. Michael Barr, in his speech, suggested that even supervisors in the US do not have the information they would need. Whether that is also the case in the UK or in the eurozone, I frankly do not know. I would not take it as a default assumption that practices in the eurozone and the UK are identical to those in the US.

I have special knowledge about one aspect of the reporting landscape. I mentioned being an independent non-executive director of the trade repository arm of DTCC—even though I am not speaking here in that capacity—which has given me exposure to the issue of derivatives trade reporting. It is a very important and interesting part of the broader disclosure and information theme, and I am happy to discuss that. Think of an incident like, for example, Archegos a couple of years ago. This build-up of exposure should have been visible through the information infrastructures that had been put in place with derivatives trade reporting since the early 2010s. Unfortunately, it was not, for reasons I can explain. There is work on information systems of the kind that are provided by trade repositories. I am duly aware of what may be perceived as my conflict of interest here—which I view not as a conflict but as a point of just better information for me about that segment. I think that it is a very important issue for financial stability authorities. It includes difficult matters of cross-border co-operation among authorities, which is sometimes impeded by national legislation, but also sometimes impeded just by the intrinsic reluctance of authorities to share sensitive information.

Lord Hollick: Would you like to see regulators push for greater transparency on the interconnectedness between the primary market and the private market, and, as you have just touched upon, the relationship internationally, because a lot of these transactions with the private finance sector from primary banks are in fact done internationally? Is there a case for much greater transparency in those relationships?

Nicolas Véron: I understand your question as meaning public transparency. Is that correct or do you mean transparency with authorities?

Lord Hollick: I mean public transparency, particularly in the context of how a lot of risk in the private finance sector is distributed to small pension funds and small investors. In other words, it is a distributed risk. In some ways, the regulator can say, “Well, that is fine. The risk is distributed; it is not concentrated”. But the relationship between the primary market and the private finance market in very great size is a systemic-ish risk.

Nicolas Véron: Pension funds are regulated and supervised. They have a prudential framework that is supposed to address some of those issues.

Whether it works or not of course depends on jurisdictions and observed experience. I am very much of the view that, you know, caveat emptor. As Commissioner Maria Luís Albuquerque, who is in charge of this in the current European Commission, put it recently—I thought it was a good way to put it—the private savers and investors should be protected from fraud and malpractice, but they should not be protected from themselves. That means that, at the end of the day, the investment of investors, including retail investors, has to rely on judgment, and there is only a certain extent to which regulation can prevent bad investment.

Having said that, pension funds are of a public interest nature. They are regulated and supervised as such and, of course, so are banks. It is a matter of fine judgment what has to go into information provided on a confidential basis to supervisory authorities, and what has to go to the public domain.

There is a good case to be made that the system cannot rely only on disclosures to supervisory authorities; there has to be an element of public disclosure that creates or fosters market discipline. As I mentioned, there is a reason why the Basel framework has a third pillar, which is specifically about that public information intended to foster market discipline. That is true of the financial system in general. We want enough information to be around so that the public and public investors have a broad understanding of the system. Having said that, there is a reason why there is a private and a public segment of the financial system, understood as publicly listed or issued securities and private investment by private credit or private equity investors. The very nature of that divide is that there is more information in the public space than in the private space, understanding the semantics as such.

Then the question becomes how private is private. Should we think in terms of thresholds? Should we think in terms of general information requirements? For example, in my country of France, every corporate entity, irrespective of size, has to publish financial statements and make them available at the local business court. Whether that is overkill or not is a matter of debate. There is no similar requirement, for example, in Germany, and that creates a big difference in the structures of the SME systems. Even so, the French requirement is not universally complied with because enforcement is somewhat lax.

It is a difficult question. My general view is that this issue should be viewed dynamically. The authorities in charge of financial stability, which practically means central banks, should have an understanding of the size and systemic relevance of private markets and the applicable regulation should give those authorities the information they need to assess the systemic relevance. I mean information available to central banks, not to the public. On that basis, those authorities in charge of financial stability—practically, central banks—should inform and advise legislators on public disclosure requirements. If there is no systemic relevance of private markets—you could say this is a bit of a Germanic way of looking at it—let private be private. Why apply public transparency requirements

if they are not needed for the public interest? So privacy applies in that case. If there is a matter of systemic relevance, then it becomes a matter of public interest. I am inclined, with some trepidation or reluctance, to leave that assessment to the judgment of central banks in their role as advising legislators. I am aware of the shortcomings of central banks in making that assessment but, at the same time, the view that the divide between private and public markets should be maintained as a matter of general policy is not absurd.

So I would view that very dynamically. I am not myself in a position to make a recommendation on exactly where the boundaries should be and what the granular requirements should be for different categories of participants in that market. I have not done the homework. But it is a very timely question.

- Q33 **Lord Lilley:** We are told that, since the financial crisis of 2008, the growth of lending by banks to business in the States has returned to the rate of growth prior to 2008. But this side of the Atlantic, both in the UK and in the EU, that has not been the case and credit growth has been slower than it was before 2008. Three explanations are put forward for this. One is that the growth of credit has been more restricted this side of the Atlantic because of a more restrictive imposition of Basel. The other is that there has been a growth of non-bank lending, presumably more on this side than on the other side of the Atlantic. The third is that demand for credit has been slower this side of the Atlantic and has not returned to the rate of growth it had before 2008. Which of those answers is true? You referred to a slower growth of demand for credit in your answer so, if that is your answer, why has demand for credit this side of the Atlantic not returned to its previous growth rate?

Nicolas Véron: There is a lot to unpack here. As you understood already, my inclination is to emphasise number three. As to number two, I guess the significance of private credit in relation to bank credit is probably higher in the UK than in the rest of Europe—to use the correct geographical vocabulary. So the UK and EU situations cannot be equated, including in comparative perspectives to the US.

Lord Lilley: Why has demand grown more slowly? Why has it not returned to the previous rate of growth?

Nicolas Véron: Economic growth has been generally weaker on this side of the Atlantic than in the US, as is well known, as Mario Draghi reports.

Lord Lilley: Why is this since 2008? You cannot explain a change by a constant: if we have been constantly growing slower, that does not explain why we have been growing relatively more slowly since 2008 than before.

Nicolas Véron: Before 2008, there was excessive credit growth in the EU. Our banking sector in the EU including, for that matter, the UK was subject to ineffective prudential regulation and supervision. In general terms, if you look at the run-up to the great financial crisis, the quality

and effectiveness of banking prudential regulation and supervision in the US was higher than in the EU, including the UK. There had been excessive credit growth in EU banking, including UK banking, in the run-up to 2007 and 2008 in a way that has not been observed similarly in the banking sector, leaving aside non-banks, in the US. So that matters for your comparison.

You need to say, "Okay, what was the starting point of this gap in prudence in the respective banking sectors?" Your base effects start to have a major impact on your comparison. I do not have the numbers precisely in mind to expand on that apples-to-apples determination. But credit growth in the years before 2007 should not be viewed in the EU, including the UK, as setting a standard of best practice. That is probably a big part of the answer.

I mentioned the absence of credit scarcity, in my observation, in the EU or UK at this point. There is also no credit scarcity in the US. As to the way in which this is addressed by banking and non-bank entities, respectively, I do not have all the numbers precisely in mind.

Lord Lilley: Thank you. So if there was too rapid a growth of credit this side of the Atlantic before 2008, that implies there was also too rapid a demand for it, if you are saying that it grows only if there is a demand for it.

Nicolas Véron: We saw that, indeed. We saw excessive borrowing in the run-up to the great financial crisis. This was generally channelled more through the banking sector in Europe than in the US.

Q34 **Baroness Noakes:** I want to explore the extent to which stress testing has been deployed by the central banks and regulators to assess the impact of the interconnectedness of private capital and the banks; whether the stress tests that have been carried out on the systemically important banks have, to your knowledge, explored the impact of that interconnectedness on individual institutions; and whether those charged with financial stability have tried to stress-test the financial systems on the broader basis of the impact of stress on the private capital markets and the impact that that would have through the financial system.

Nicolas Véron: This issue of stress testing has to be viewed dynamically because, 10 years ago, stress tests were established practice in the US, which was viewed as having best practice for stress testing. You can see, for example, the book on stress testing by my former colleague at the Peterson Institute, Morris Goldstein, *Banking's Final Exam*, which very much crystallises that stylised picture, which was accurate at the time, 10 to 12 years ago.

In the meantime, there has been a build-up of stress-testing practice in the eurozone and UK in particular. At the same time, the practice in the US has deteriorated significantly in quality. That deterioration will probably accelerate under the current leadership in charge of that kind of activity.

Essentially, I am saying that the US was better than Europe, the EU and UK, 10 years ago. Now, the EU and UK are probably better than the US in terms of stress testing quality. That does not mean the EU and the UK are where they should be, by the way. On the extent to which that includes private credit, again, I have not done the homework; I do not even know to what extent that information is available in the public domain. That could be different between the UK and the eurozone or the rest of the EU. Maybe it is; I have not checked.

My previous point applies here: authorities in charge of financial stability have private credit on their radar, so I am confident that they have considered it for stress testing. The extent to which they have implemented that consideration so far, or plan to implement it, I do not know.

Baroness Noakes: Is there any way of finding out?

Nicolas Véron: I should have worked on this. I was not able to do so in preparation for this hearing.

Baroness Noakes: It is not a criticism of you. I am sorry; it was a general question on whether I could go and look for something somewhere.

Nicolas Véron: Central banks disclose some of their stress-testing assumptions. They, of course, disclose the macroeconomic scenario under which they stress-test the banks. They do not necessarily disclose every single element that goes into their stress test practice, including modelling, if they do any. The way in which the modelling practice is shared between the central banks, prudential authorities and the banks themselves differs a lot between the US, the UK and the eurozone. So you have different ways of sharing the burden of stress test modelling, which has also evolved over time. It is a complex issue. I do not have a recent update for you but some of that is disclosed by the central banks and prudential authorities. Possibly there is more that they would be willing to share in a public hearing. So the usual instruments apply.

Q35 **Lord Hill of Oareford:** It is good to see you. Can I just test a couple of things with you? You argued, as have other witnesses we have had, that you do not immediately see financial stability risk from the spread of private credit. If that is the case, is it your basic view, therefore, that this is a benign development? If there is less financial stability risk, should this be encouraged?

Nicolas Véron: Nothing is forever benign in the financial system. Financial stability authorities should be paranoid. They are—or, if they are not, they are not doing their job. Assessments such as the one you suggested, on whether the development of private credit is a good or bad thing, are dynamic in nature. They are not made for ever; authorities have to update them constantly.

There has been a pretty long period of time in which there was a convincing case to be made that private credit was benign and investors

had enough skin in the game, so the incentives were the right ones. Essentially, investors had loss-absorbing capacity, and that was the right framework for risk-taking. As I mentioned, from listening to Michael Barr—among other sources—last week, my impression is that, in the US, there has been a shift away from that picture of benign private credit because of the build-up of leverage and the involvement of life insurers, some of which are controlled by private credit groups, in the business model. Whether that also applies in Europe at this very moment—and, maybe, in a differentiated way, in the UK and the eurozone—is a question to which I do not have an answer.

Again, this is dynamic. You need to rely on recent information. I have not done that work but the answer to your question is that, certainly until recently, the “benign” epithet probably applied. Whether it applies now, I am not sure. It will certainly not always apply in future; it cannot be taken as a default assumption. Therefore, if you are thinking about legislation and rule-making, which I think was implicit in your question, to set incentives to invest in private credit—for example, in terms of tax treatment—I will be a classic economic type here and say that distortion should be minimised. It should be left to the judgment of investors which segments of the financial system they want to invest in.

I am very cautious about creating incentives for investment in private credit. This segment has, as you know, developed as a purely market-driven trend so far. That has not prevented its development, so I do not see a case for the authorities—particularly fiscal but also super-regulatory ones—to go out of their way to give them a comparative advantage.

Lord Hill of Oareford: That was not meant to be implicit in my question at all. I was approaching it from the other end really—that you can see people starting to raise the question of whether you need to regulate and restrict the growth of private credit. As you might expect, I do not think that one needs incentives, as you rightly point out, to stimulate further the development that is happening of its own accord.

The other thing I want to ask you about is your view on whether the regulation of the banking sector that we have seen has had any effect at all in stimulating the growth of private credit markets.

Nicolas Véron: Private credit is intrinsically a consequence of the fact that banks are regulated. Banks are regulated for a good reason: they create money, which is important to the public interest. So far, private credit groups have not created money in general. As you know, the definition of “money” is tricky.

The concern is that we may be approaching a point where private credit investors create money in some ways, although we are probably not there yet. If that is the case, there is a case for regulation. It really depends on the nature of the business models and practices in the public’s perception. The same is true of crypto, by the way.

I am certainly of the view that anything to do with money must be regulated. Defining what has to do with money is very dynamic. Financiers have since the beginning of financial times, if I can put it that way, constantly tried to create money outside whatever segment of the system is under public oversight. In a way, there is nothing new under the sun, but, again, I insist on the dynamic nature of that question.

Lord Hill of Oareford: We have discussed many times over the years the relative overdependence of Europe on the banking sector as a means of providing money for growth. You have just made the point that there must be some effect through the regulation of the banking sector on the availability of capital. Given that we are still waiting for the savings and investments union to fill the gap, should Europe not want to see more rapid development of private credit to fill the gap that has perhaps been left by the overregulation of the banking sector? Or do you not see it like that?

Nicolas Véron: I would say that it is 100% part of the savings and investments union. If the savings and investments union means something—that is an open question—it has to include your question. What is the issue here? We have debated this for a long time. Arguably, the starting point was not when Jean-Claude Juncker coined the capital markets union in July 2014 but, rather, the Segré report to the Commission of the European Economic Community more than half a century ago in 1966.

What is the savings and investments union or, to use the old-fashioned language, the capital markets union? It is the vision that there should be proper conditions for non-bank capital market activity to provide the funding that the economy needs, complementing bank finance. Capital markets also have to be regulated in a different way from banks. It is not about prudential regulation; it is mostly about conduct. The UK architecture has a neat differentiation between the PRA and the FCA—this is a wise choice, by the way—but that has to be managed effectively. I believe this has been the case so far in the UK.

The real issue in the EU is conduct supervision, which is what has been lacking historically. I have one word to summarise the situation: Wirecard. In the biggest country of the European Union, Wirecard demonstrated that the supervision of the conduct of business and the oversight of capital markets activity were failing in almost any segment you can think of: accounting, auditing, listing, public disclosure requirements of listed firms—you name it. Of course, this included public transparency. Famously, BaFin sued *FT* journalists when they revealed what was going on instead of caring about what was wrong at Wirecard.

When you have that extent of systemic failure in basic oversight and supervision requirements in the biggest economy, it is not surprising that the development of capital markets in the EU is lacking. We have had this discussion before. The reform of supervisory architecture is front and centre here; it may not be low-hanging fruit, but it is at the centre of the discussion. Now that the UK is outside the EU, it should be actively

understood in the UK—as it is, I think, in many parts of the UK policy-making environment—that capital markets’ development in the EU requires supervisory reform and supervisory integration.

The central issue of the savings and investments union—including, indirectly, the development of private credit to the extent that that development is benign and useful—has to be complete, ambitious reform of what is currently a dysfunctional supervisory framework for the conduct of business in EU capital markets.

Q36 Lord Vaux of Harrowden: Could you provide your reflections on the conclusions and recommendations of the Draghi report on competition in the EU banking sector and the overreliance of business, as he puts it, on the banking sector? What impact do you expect that to have on the future regulation of banking and private credit markets over the next few years?

Nicolas Véron: The Draghi report, as my colleague and boss at Bruegel, Jeromin Zettelmeyer, eloquently described it, is a mixed bag. There are some very good things in it. The general emphasis on the sense of urgency to work on European productivity and competitiveness is absolutely sound and timely.

When you look at the details of the recommendations—again, pardon my French—it is a bit of a dog’s breakfast. On the financial sector recommendations, it is not even clear what process led to the way that the relevant Draghi report sections were drafted. Some of those recommendations are sound, some are half-baked and some are questionable. I do not think that they are the Bible for subsequent EU policy action. I do not think they are viewed as such by the European Commission even though, at a high political level, the Draghi emphasis on competitiveness and productivity is correctly taken as a mantra by the European Union. Essentially, I would use the Draghi recommendations on financial services reform as inputs and reflections for the EU but not by any means as an untouchable road map.

Lord Vaux of Harrowden: The one regulatory point that he raises is on difficulties around the securitisation of debt. Do you agree with that issue?

Nicolas Véron: I do not think it is the biggest issue in the landscape. Last month or earlier this month—I do not remember exactly—the European Commission made proposals on securitisation. A process will now start to bring them to fruition. I do not think that changes the game in a major way. Compared with other things we have talked about today, this is a relatively niche concern, albeit a legitimate one for discussion.

The broader question that is very much in the landscape—of course, I paid attention to the Chancellor’s Mansion House speech a few days ago—is one of simplification and the subtle dialectics between simplification and deregulation. Simplification is not necessarily to be equated with deregulation. There can be scope for simplification that

makes the life of business and banks easier without amounting to a relaxation of the legitimate requirements for prudential and conduct-of-business policies. We have ample scope for that in the EU, perhaps more than in the UK; in the EU, a major driver of complexity is the uneasy compromises that have been made over time between the national and European levels, which do not have an equivalent in the UK. For the purposes of this discussion, the UK is a unitary state with, therefore, a very simple single jurisdiction which encompasses all the lands and countries of the realm—not of the Crown, I guess. My vocabulary is probably not exactly right, but you will correct me appropriately.

There is a lot of scope for that kind of simplification in the EU. My Bruegel colleague Juan Mejino-López and I produced a study a couple of weeks ago for the European Parliament, which I think has been circulated to this committee. It goes into how to simplify the macroprudential framework and the banking framework more broadly through the completion of the banking union. We know that this is politically difficult, and I do not expect it to happen tomorrow morning, but completing the banking union is actually the biggest thing that the EU could do to simplify its banking policy framework in a big way.

It is similar, by the way, to the recommendation on the integration of capital market supervision that I just outlined in response to Lord Hill. The latter is mostly about the conduct of business and therefore does not have the quasi-fiscal undertones of the banking union and prudential discussion. That supervisory integration, if done well—I have just contributed to that debate with a publication at Bruegel—would be a massive simplification of the capital market environment in the EU. Again, these issues of national versus European do not translate to the UK. They are interesting for the UK to observe because the EU is next door, but they are not relevant to the domestic UK discussion.

Is there scope for massive simplification in the UK? I am not sure. From an international perspective, as you probably know, both the UK regulatory framework and its supervisory implementation, primarily by the PRA, the FCA and the FRC, are viewed as global good practice—in some segments, even best practice. I do not view the UK as having a particularly acute problem with supervisory effectiveness, including on this concern about complexity or simplicity, but, of course, no system is perfect.

The Chair: We might send you a copy of our latest report on that matter.

Q37 Baroness Bowles of Berkhamsted: It is good to see you again, Nicolas. I would like to go back to what you said about caveat emptor and to Lord Hollick's questions about transparency, because they kind of go together. There is a head of steam building up in the UK at the moment to encourage more retail investment not just in equities on the stock market but in private capital instruments. Is that balance right? You can stress-test what the banks or an insurance company hold—those things can go on—but how do you stress-test what is in an individual

pensioner's portfolio, especially if they are being directed that private capital is a very good thing, when a lot of it has become extremely illiquid? I realise that that is a very all-encompassing question, which I am sure you are used to, so do your best.

Nicolas Véron: This is also an age-old trade-off. If you want to protect retail investors, you have to bar them from investing in things that, even with good financial education, they will not fully understand. Then you reserve those investment opportunities for professionals, but that means that those professionals have access to better investment opportunities than retail does. That is kind of shocking from a public perspective, even though there is a certain logic to it. That trade-off is difficult to manage politically; it always has been and always will be.

That is why pension funds are regulated and supervised. If you look only at the UK, the relatively recent episode of liability-driven investment funds engaging in practices that were not perhaps optimal was, frankly, a failure of supervision. It probably was not viewed as such to the extent it should have been, at least in the public debate. The British media are very vibrant; I have not read everything that was written about the LDI episode, but to me supervisory failure was a major component.

I have not followed the UK debate enough to know to what extent it has led to a reform of pension fund supervision, but pension funds are supervised. Conversely, if I engage in day trading from my computer and buy and sell securities or crypto, that is my risk. I think that is fit and proper. Yes, financial education can bridge that gap to a certain extent, but only to a very limited extent. Historical practice has been sobering in terms of financial education as a policy instrument to help manage this kind of risk, so it probably has to remain the case that some pretty juicy investment opportunities are not open to retail investors, just because there is too much complexity and the relevant information cannot be entirely provided in the public domain, as a matter of general principle.

Policymakers, political leaders and elected politicians have good reasons to minimise the gap between the investment opportunities available to the general public and those available to professional investors. The gap should be reduced to a reasonable extent, but it cannot be entirely eliminated.

Baroness Bowles of Berkhamsted: So you do not use retail involvement as a reason for having additional transparencies. Whether the investment is accessible or not will still be a supervisory decision, so this is going to be a very grey area.

Nicolas Véron: It calls crypto to mind, even though we have not talked primarily about crypto today, which is a relief for me. We have contract freedom in our systems and freedom for private parties to engage in financial transactions that are not regulated by default. That includes the provision of public transparency. If we want to keep that fundamental feature of our system, which is generally good if properly managed, we

will always have situations where retail investors engage in transactions for which there is no publicly enforced transparency.

Crypto is a massive illustration of this feature. We can discuss whether it has gone too far, but it was not unreasonable at the beginning of that sequence for authorities to say: "This is caveat emptor territory and we are not regulating it, including for transparency purposes". Of course, the crypto service providers say that there is total transparency because it is crypto but, as we know, this proposition has to be somewhat nuanced. That is even more the case when we talk about stablecoins.

There are lots of issues in your question, but I maintain my general view that there will always be a space for private contractual freedoms that is not covered by public transparency requirements. That is an inescapable feature of our market-driven system.

Q38 Baroness Donaghy: You referred earlier to the dysfunctional supervisory system. What concerns me, as an ordinary member of the public, is how we can trust that system if, as you imply, it is not sufficiently joined up to see things coming down the line. One aspect of some of the biggest financial scandals is that outsiders did not see anything coming and there is lack of visibility about the extent to which insiders knew what was coming down the line. What reassurance could you give me that this dysfunctional supervisory system has a handle on, say, the valuation of the private system, the visibility of bad actors and the responsibility for supervisors' failures?

Nicolas Véron: I am not sure I was clear enough: when I referred to a dysfunctional system, I was referring to the EU supervision of capital markets, not the UK. The reason why the EU system is dysfunctional, as I elaborate on in my essay recently published by Bruegel, is, in essence, that it does not have the right incentives. National capital market supervisors in EU countries, because of the existence of the single market, have incentives to promote and protect national financial champions, which is exactly what happened with Wirecard, to the detriment of their public interest role of enforcing conduct-of-business requirements and some prudential considerations.

This assessment does not apply to the UK authorities, whether the FCA, the PRA or the FRC. They do not face the same perverse incentives, which, frankly, are a consequence of the single market. One reason why they do not face those perverse incentives is that the UK has left the single market, which is not necessarily a good thing for the UK but closes that gap in supervisory governance. I am not sure if that is clear enough.

Baroness Donaghy: It is clear, but it still implies that there is a difference of emphasis in the international supervisory world. There are different systems and insufficient joined-up supervision.

Nicolas Véron: As I mentioned, UK supervision in that domain is generally viewed as good practice. That is good news for the UK. International co-ordination is difficult. I said very critical things about

how it works in the EU, because of the incompleteness of the single market's supervisory architecture, but even the EU is better than some other jurisdictions around the world. Actually, it is probably in the best quartile in terms of countries or population. It is all relative.

Obviously, we do not have a world government and can only strive for global cross-border convergence and standards, which we should build up. That particularly applies to transparency requirements. I would be delighted to expand on the important, if limited, segment that I mentioned of derivatives reporting and transparency. I think we are missing an instrument for global co-ordination, better practice and a more joined-up framework in that area, but we must also be realistic about the scope for full convergence of outcomes at an international level.

Looking jurisdiction by jurisdiction at how we can trust supervisors is a constant work in progress. Supervisors can fail at any moment. They have a very difficult job of ensuring constantly high levels of supervisory performance. That is why I mentioned that they must be paranoid. By the way, that applies to prudential regulators and conduct-of-business supervisors such as the FCA and the FRC. If that leads to them being deemed risk averse, it is probably a feature and not a bug. To the extent that they have a public interest mandate, they have to care about risks and to avert them. That can run them into overdrive. It is the job of legislators to check that, but the risk aversion of financial supervisors is generally to be welcomed.

That is why legislators should not regulate everything and scope should be left for contractual freedom without public supervision when it does not extend to systemic relevance, as I mentioned in response to the previous question. This is very important; there are multiple trade-offs here. Generalised heavy-handed regulation is not the answer, nor is completely laissez-faire regulation. We have learned that at great cost. Finding the right balance is incredibly difficult and has to be revisited every day.

Baroness Donaghy: It would be very useful if you could provide us with more information about the visibility and data issues.

The Chair: On that note, Monsieur Véron, we have run out of time. On behalf of the committee, I thank you for a fascinating session. You have drawn out some of the balances that need to be set and explained the background to these quite complex issues. Thank you very much indeed. We will send you a copy of the report, and we would be very interested in your comments on our comments on the degree to which the regulators are too risk averse.