



Treasury Committee

Oral evidence: [EU Financial Regulation](#), HC 845–i

Wednesday 27 November 2013

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Members present: Mr Andrew Tyrie (Chair), Mark Garnier, Andrea Leadsom, Mr Andrew Love, John Mann, Mr Pat McFadden, Jesse Norman, Mr David Ruffley, John Thurso

Questions 1–51

Witnesses: **Dr Gerard Lyons**, Chief Economic Adviser to the Mayor of London, **Jim O'Neill**, Visiting Research Fellow at BRUEGEL, Chair of Cities Growth Commission and former Chair, Goldman Sachs Asset Management, and **Sir Nigel Wicks**, Chairman, British Bankers' Association, gave evidence.

Q1 Chair: Good afternoon. Thank you very much for coming to give evidence. We are very grateful to all three of you. Can I begin with a straightforward question that may not necessarily have a straightforward answer? Of course, the financial services industry is particularly important to the UK—we have got two-thirds of the wholesale markets in Europe—and much more important to us even than, say, the car industry is to the Germans or agriculture is to the French or the Italians. What is it that we think Brussels can do for us and do to help our industry compete globally, and what is it that they are doing that is getting in the way? Why don't I start with Dr Lyons and then go to Jim O'Neill and then Sir Nigel?

Mr Love: You have drawn the short straw.

Dr Lyons: Good afternoon. It is a pleasure to be here. In terms of the City, I would differentiate between the retail sector and the wholesale sector. Often, the complaints I hear or worries about Europe come more from the retail side than from the wholesale side. I am not an expert on this, so I am looking at it from a macroeconomic perspective and I might miss some of the fine detail, but my understanding is that the problem we had in monetary policy, which is one size does not fit all, seems very much to apply in the retail sector, which is why there is a lot of noise around there and why there is a need to differentiate between the different structures of the retail markets across Europe. The essence is: Europe is trying to say what is required to make life better for the consumer in terms of better and best protection, but what seems to be happening is that Europe is pushing directives, not regulations, so things are being imposed on a UK retail sector that is far more advanced than on the continent. There are about 4 million UK consumers who save, invest or are involved in the UK retail financial sector, and I would imagine that the message they are constantly bombarded with is that they are being hit by further regulations from Europe. From the European side, there is the need to differentiate across the retail consumer sectors.

From the UK perspective, it seems to me that we are very good tactically—I would apply this to the wholesale sector as well as the retail sector—by which I mean that we are very good at fire-fighting or responding to problems as they are arising. I am not sure we are as good strategically in terms of being involved at an early stage of the process to influence the debate as much as we can.

The final point on the retail side—again, I am not an expert—is that just from reading the financial press and talking to people in the City, the whole idea of passporting comes up. Some of the big problems that have cost the UK industry, asset managers, life insurance maybe but certainly the retail side, are things that have been passported in from Luxembourg. Because they are in the EU, their regulation applies to London, so there is the passporting issue as well. In a nutshell, there are a lot of micro things, but it is effectively the same issue we had on the monetary policy side, which is one size does not fit all, and bringing that down and recognising that there is a difference.

In terms of the wholesale financial sector, Open Europe have pointed out a figure that is regularly quoted, so I am quoting it second hand, which is that services account for about three-quarters of the European economy, but in terms of the exports and imports within the internal market, services only constitute about a quarter of the economy. The point from the UK side that you usually hear is that we need to make the single market work properly.

The way I tend to see it is that we can think about almost four different aspects, one of which is non-economic, which is foreign affairs and all those issues. Park that to one side, and then you have three different aspects. There is the eurozone, of which we are not a part. Then there is the single market—a single market in terms of the four freedoms and the core competencies, with the Cabinet Office and so on looking at this. That is where people want things to work properly, making the single market work properly. Then there are the other economic issues, of which there is a lot clubbed together in there. That, it seems, leads to a lot of regulation. What people want in the UK is to make the single market work properly, particularly within financial services.

Just to conclude because we can take this further, and obviously my colleagues have a lot more to say than I, the other issue is the relationship between the EZ and the non-EZ, i.e. the relationship between the eurozone, the EZ group, and the non-eurozone group. This is work in motion, shall we say? We need probably to be engaging as much as the continent. It seems to me that we approach this very much from an economic and financial issue, whereas the continent maybe approaches it from a political issue. Therefore, we need to have greater clarity about where we stand at the beginning of the process. In terms of the EZ and the non-EZ group, it is about how that relationship would work in the future, including between the Bank of England and the European Central Bank. To conclude, there is the whole issue about engagement as well, so there is a whole host of broad issues and micro issues.

Chair: We want to explore those in more detail, but let us just get a quick further view from Mr O'Neill and then Sir Nigel Wicks.

Jim O'Neill: Okay. Thank you also for inviting me here. Can I just make clear that in talking on all these matters, because sometimes people forget, I left Goldman Sachs seven months ago? I am no longer at Goldman Sachs or Goldman Sachs Asset Management. In that regard, I might have a different view on some issues than they might. I am certainly

not here representing Goldman Sachs, although obviously having had 20 years there I am influenced by my experiences having been there as well as other things.

I guess I have maybe two and a half or three comments. First of all, like Gerard, I would also make a distinction at the start but in a slightly different way of doing it than he suggested. I would distinguish between British banks and the City. Frequently, in so many areas that this Committee and others have engaged in and opined on over the past interesting years, it seems to me that quite often that gets lost. I say that because if I think of your specific question, your exact question, I think maybe there are some things to be learnt from the continent, if not necessarily Brussels, about how our banks engage with the rest of the economies. I often think the nature of how the German banking system has developed historically, particularly the Landesbanks and the Sparkassens in the function of some kind of national post-war regional development; they see their role as being part of a broader economic community and are not quite so motivated as perhaps some of our banks have become. I do not know whether there is a great deal to be learnt from Brussels in that regard, but there may be some things to be learnt from parts of the continent.

Against that, and going to what I hear as the tone of your question—maybe that is just me reading things into it—I do not know what can be learnt because, as you also implied, emphasising the importance of financial services for this country, in a global sense there are not many sectors of life where Europe has that expertise for the world as the City does for the UK and Europe. They should think a lot more carefully about some of the consequences of their decisions.

Why I say two and a half, it seems to me, touching on an aspect that I thought of while Gerard was talking, a lot of the decisions in the past three-plus years are basically being driven to ensure the survival of the euro, not necessarily in the greater interests of the EU and all its members, in my opinion.

Chair: I am going to move on to Sir Nigel because we will get more detail on all of these, but just a quick response as well, anything that you want to add.

Sir Nigel Wicks: Yes. Going to your question, I think you have to start from the fundamental point about what the purpose is of financial services. The purpose of financial services is to provide a service to individual consumers—retail—and businesses, which is a retail but also a wholesale. To answer your question, what we want from the European Union as far as British citizens are concerned, is a financial services framework that helps us serve the consumer and serve the business community.

Q2 Chair: Okay. Well, are we getting it, and in what ways are we not getting it? That is my question.

Sir Nigel Wicks: Well, I think the answer is up to a point, if I might put it that way. I think to an extent we are. Take, for example, the key fundamental, which is financial stability. Some few years ago the G20 set out a programme for achieving financial stability. Virtually all that programme is being delivered through the European Union. We have our own things that we are doing in the UK—for example, the John Vickers proposal and all those—but a great deal is coming from the European Union. That is something that is absolutely essential and it is right that it is done on a continental basis, the whole of Europe, because if there are problems in one member state, with contagion and the

linkages between the banks they can so easily spread. One of the things that they are doing to help is trying to get a financially stable situation in Europe.

Not everything they are doing is helping. In this country, in the financial services area here, in the wholesale, it is a global business. You can tell that if you go round many of the large foreign investment banks in London. They have their global heads for EMEA—that is the European, Middle East and Africa region—in London. Sometimes, what comes out of the European Union is not helpful for the banks in the City of London penetrating new markets abroad. I will give you two examples.

Chair: Yes, give us two quick examples.

Sir Nigel Wicks: One of the things that the Commission is much enamoured with is the concept of equivalence: that is, before you allow businesses established within the European Union to operate in a third country, that third country has to have arrangements for clearing houses, CCPs, that sort of thing, equivalent to what we have here. That is asserting a sort of extraterritoriality, saying, “Our banks can go up there provided you have the same standards as ours.” That can be unhelpful and in some parts of the world they do not much like it.

Another quick example—and this is a rather controversial example but I will nevertheless make it—is you can make a good case, though some people would dispute it, for the proposals on bonuses and bonus caps that have come out of CRD IV. However, it starts to cause problems for European banks—I am talking about not just British banks, but banks right across the whole European Union—when they are applied to subsidiaries of European Union banks in third countries when they are not applied to the non-European banks that are their competitors. For example, and I simply make it up, take Santander as a European bank operating in Rio or Sao Paulo: its people there are caught by the bonus cap, whereas JP Morgan or Citi operating there is not. There is anecdotal evidence that that is inhibiting the European banks operating in those jurisdictions.

Chair: Okay, helpful examples. I think we are going to need to get into more detail.

Q3 Jesse Norman: Can I just ask you, Dr Lyons, if you can give us a quick sense of the geography of Europe from a financial standpoint? Who are our allies among the Euro-bureaucracy and who are our enemies, as you see it from a City of London perspective?

Dr Lyons: Thanks for the question. I do not think there is any right or wrong answer to that and it is very difficult to quantify the answer. Let me approach it in two different ways.

I think the key issue facing Europe, including the UK, is how we reposition ourselves in a changing and growing global economy, which is why the last point Sir Nigel mentioned about the third party is key. Within that, the key issue is where the financial sector and the City stand. The City is Europe’s financial centre, so in relation to the size of the European economy the City is not that big, but in relation to the size of the UK economy it is huge, hence all the problems we saw in the crisis. That is the first point.

The second point follows from that. Coming back to that, I think we need to position how the financial sector is seen within the overall economic picture and within the overall economic aim. Now, as Jim O’Neill touched on, a lot of the issues in the last few years on the continent have been more about fire-fighting—he did not use those words, but it is

about protecting the euro and protecting the eurozone in particular. Given all that, my view is that all of the euro area should be our allies if we present the case right for the importance of a good financial centre: good to service the UK, good to service the continent, good to position us. The reality, however, is that we are some way from that.

If we look at it in terms of which countries might be trying to force reform within Europe, in generic terms not just in financial terms, the Dutch over this year seemed to, and the Swedes have. The Germans seem very keen on reform but they are approaching it more, I would say, initially from ensuring that the eurozone itself is strong. There are a number of coalitions or potential economies that should or could come together in terms of the reform process.

The other aspect is that, given where we are at the moment, the non-eurozone members should be our natural allies. I am sure you are aware that the two countries that have said that they will not join the eurozone are Denmark and the UK. All other countries are obliged to join it. At the moment, as things stand, that group should be our natural allies. The other people who should be our natural allies are the people who want to reform the European area. Beyond all that, if it is about repositioning Europe, then we should all pretty much be in the same position. It is very much coming back to Sir Nigel's point about how you position the financial sector as helping the economy.

Q4 Jesse Norman: Where does the Commission fit into this and where does the ECB fit into this?

Dr Lyons: I am not sure, is the answer to that. The ECB is, as I see it, very much there to ensure that the eurozone is doing well. A banking union has yet to fully develop so there are lots of issues there in terms of fiscal issues, not just normal monetary issues. In terms of your previous question about allies, the Bank of England and the European Central Bank need to develop further the clarity about how things will behave between the non-eurozone economies and the eurozone economies. That is seen as an important bit within the City. The ECB has played a fantastic role on the continent in the last 18 months. They probably should be seen as our allies in making the whole market and the economies perform well.

Q5 Jesse Norman: Okay, thanks. Sir Nigel, are there particular segments of the financial services area where you think the City holds a particular comparative advantage?

Sir Nigel Wicks: Yes. One is that we hold a particular comparative advantage because in London we do such a lot of things that there are cross-synergies. Because we can offer a complete package, that is a very big comparative advantage. If you go to Dublin or Luxembourg, they are great for funds, but in London you can offer the whole range of services in whatever currency you want; we have lawyers in the City who will write whatever contract you want and whatever law you want. That is the great advantage of the City. In some sense, it is one of our risks, one of our danger points, because if we start contracting and start losing some of these important elements to the total package, it weakens the City as a whole. I am therefore very pleased that the Chancellor of the Exchequer is making great efforts to get the renminbi market in London. We hear talk of an Islamic bond being issued here in London. That is working, in my view, in entirely the

right direction because it is broadening the portfolio of products and services that we can offer and, therefore, improving the position of the City in its entirety.

Q6 Jesse Norman: If you were doing an economic analysis, you might take the view there are some areas we should not be playing in because we are never going to be a low quality, low price, mass volume player in some areas. We should be focusing on high quality and high price and high reputation. Is that your view?

Sir Nigel Wicks: No. Clearly, if you ask the City people, they will like the high margin and high value businesses, but if we are just going to say we are going to be a boutique or niche player, I think we will be dealing ourselves out of a lot of global business.

Q7 Jesse Norman: Right, thank you. Jim O'Neill, do you think that some of the recent relative falls in the ratings of the City of London have been due to the many reputational issues that our banks have faced over the last three to five years?

Sir Nigel Wicks: That is undoubtedly a contributory factor. It is not the only factor but it is a contributory factor. It is in the interests of the City, of the London financial market, the UK financial market, that we are seen to have a palpably honest, open, transparent and fair financial market. Certain of the things that have happened in recent years have not demonstrated that. There is work to be done to demonstrate it and it will take several years to demonstrate that we have that sort of market. But there are other reasons why we may have slipped down this index.

Q8 Jesse Norman: We will come on to those. Let me just ask Jim O'Neill quickly if he wants to comment on my question about reputational damage.

Jim O'Neill: I just want to be sure. Are you asking in terms of our reputation in Brussels or our general reputation?

Jesse Norman: Generally. Obviously, we are thinking about Europe particularly at the moment, but essentially undermining our claims to—

Jim O'Neill: Even though you did not ask me this, I want to precede this by also quickly answering you about comparative advantages. I have always jokingly said the biggest threat to the City would be if New York changed its time zone by five hours. We have incredibly important simple things that are impossible for anybody else to compete with: the time zone, the language, and a hugely deep, skilled and flexible pool of labour.

By the way, in all the rantings and ravings about the City—I am going to come to your other question—it is frequently forgotten that I think for the past 30 years it has contributed about 2% of GDP invisible surplus, without which we could have had some severe balance of payments problems. There are very few parts of the UK that could do that for such a long period.

Obviously, there have been events over the past five years that have damaged the reputation as such, but, as difficult as the interplay between real damage and a desire to seem populist and to blame is, the previous points I made need to not be forgotten because they are hugely important advantages that we have for this massively growing global industry that are not so easy to find in other parts of life here. In my opinion, a lot of the

problems are because of issues about the regulatory environment that has presided over how the City has evolved, not necessarily a genuine reflection of how the hundreds of thousands of people that work in the City behave.

Q9 Jesse Norman: Can I ask one final question, Chairman? Just back to Sir Nigel, if, as you suggest, some of these scandals have undermined our credibility with these European institutions, do you think there are offsetting factors that we can look forward to restore our position? Is there a danger that the European countries or institutions may start ganging up against Britain and using that lack of legitimacy from those scandals as a cause of action?

Sir Nigel Wicks: Well, there undoubtedly are people in the mainland of Europe, as there are no doubt in this country, who are antipathetic to a free, open market, properly regulated financial business, and they will use these scandals that have happened in the debate against the sort of business that goes on in the City. We will have to combat that by pointing out the arguments in the opposite direction, but the best way of combating it is to show that these very unfortunate episodes have taken place in the past, and we are working very hard and hopefully with some success to prevent that in the future.

The other point, which is a wider point we must get across and has been touched upon by my two colleagues, is that the City is not only a benefit to the UK, it is a real benefit to the European Union. London will always exist in terms of a financial market, it will always exist in some form or other, but say it did not exist. Where else in Europe would it be? Now, I have respect for Paris, I have respect for Frankfurt, but I for one moment do not see them being able to replicate what we have in London. The services that the mainland members of the European Union call upon in the wholesale financial markets, they would not be able to get in Europe; they would have to go wider abroad for that. We must continually make the case—and we have to do it with a voice of some humility, which we are not always very good at doing—that the financial markets in this country are there to serve the interests not just of the UK but of the citizens of Europe as a whole.

Dr Lyons: Can I just make two very quick points?

Chair: Very quickly, and then I am going to bring in John Mann.

Dr Lyons: The first point is in the context of your question about friends and allies. One of the concerns in the City is the whole change in the voting structure, which comes into effect next year. The point made, for instance, is that France has effectively a veto to protect its agricultural sector, whereas we do not really have anything to protect the City. The change in voting structure, which is based, as I understand it, on the population because of the Lisbon Treaty, means that we now have a minority in terms of anything to do with the financial sector, so we can be outvoted. Some people fear there might be a structural bias among eurozone members, so that future voting structure is a key issue.

The second very quick point in terms of the survey is that macroeconomic environment is very key in terms of how people often judge things. It is not just regulation. For instance, in the global competitiveness index we fell a couple of points. The issue I would stress is it is not just about the competition of London versus Frankfurt and Paris. The key issue in the future debate is the point that Sir Nigel made about the City helping Europe. It is about how we position ourselves given what is happening in the rest of the world. The City

could easily do relatively well in Europe but stagnate as people move business, or grow business more likely, in other markets overseas.

Chair: I have seven more colleagues who want to come in so I am going to have to ask for quicker questions and quick replies if at all possible, with the replies supplemented if necessary with written evidence if you feel we are not giving you the chance to say what you want to say.

Q10 John Mann: I only have one question. It is interesting that you are all predicating your remarks presuming we stay in the European Union. When we do these kinds of inquiries, as almost a balance we can look at what is happening and comment on what is happening or we can try to home in on what we would like to do about what is happening. If you are going to pick, each of you, one specific area where you think that, in terms of the generic UK interest, we would be well advised to home in on and try to influence what should be happening with a whole raft of directives and so on coming from the European Union at the moment, which one would it be?

Jim O'Neill: As it relates to finance?

John Mann: Yes.

Jim O'Neill: In the spirit of how you ask, instead of wasting time on the financial transactions tax, which is what quite possibly as a result of the German Coalition is going to get even more energy, implement genuine cross-border services reform. That is hugely important for Europe and the UK, which they have never done.

Q11 Chair: Meaning what, Mr O'Neill?

Jim O'Neill: I think Gerard said 75% of the EU economy is services. In the rationale for why the EU exists in the first place, it is to create greater economies of scale. By and large, most policies that get debated resist cross-border services integration. It is a major shortfall, in my judgment, of the EU's success to date and is something that is vital for this country, which has even more of its GDP in services than the average of Europe.

Sir Nigel Wicks: If I had a list of six points, Mr O'Neill's point would have been one of the six, but I will give another one. For every piece of legislation, for every action that is taken by the Commission, the Parliament or by the Council of Ministers, they should ask themselves—and I am talking about the financial area—how does this impact in Korea, China, Brazil and the rest of the world? Does it help our financial industries compete there and does it help their financial industries, in a sense, come into our markets? That is what I would put on my list.

Dr Lyons: Yes, I very much reinforce that last point. Think global and act regional. My answer would probably be more generic. What I always hear is that we as a country, or Whitehall, Westminster, however you define it, do not engage properly. We are very good tactically but not good strategically. Mr Norman asked the question about the Commission. I hear that we do not have people engaged early enough.

Chair: I think we have the point on board.

Q12 John Thurso: Can I turn perhaps to Dr Lyons first on the question of Liikanen? We took evidence on the Banking Commission regarding the proposals in Europe, and I think in October there was a report back from the expert group to the Commission that indicated the directions they might be going in. As far as we are concerned, is that complementary with what we are doing in our ring fence, or is it contradictory? Are there dangers? Can we work together or should we be doing something about it?

Dr Lyons: Yes, I would see it complementary in the sense that even though not everyone is saying the same thing, we are still in the transition process following the crisis. When the crisis hit, it highlighted the scale of the shadow banking industry. It highlighted the high scale of intra-financial activity, but it also highlighted the need for our banks to be well capitalised and liquid. What I think we have in the UK is a pretty good post-crisis macroeconomic framework. The Vickers Commission was quite good in terms of its proposals, and I think we should follow them.

Coming back to Jim's point about regulation, it is almost like a pendulum. We have gone from one extreme of being relatively light and we have now gone over to the other extreme. Lots of people are trying to do different things facing problems in front of them, so in some respects it would be a surprise if we all said the same thing. Even though some people are saying different things, we are all trying, it strikes me, to get to the same destination. In that respect, I call it a complementary process but it still needs to evolve.

Q13 John Thurso: Mr O'Neill, would you agree with that in that we are ring fencing deposits, Liikanen is ring-fencing proprietary trading, and Volcker was attempting to separate the two? Are we all going in the same direction and, therefore, we do not need to worry too much? Or if we are taking evidence from people in Europe, what should we be looking for in the interface between our implementation of Vickers and Liikanen's proposals?

Jim O'Neill: Two quick comments. Compared to some other things, there is more complementarity about this than those, quite considerably, so in that sense it is not bad.

The second comment is—I could spend days talking about this—I personally think our central bank governor has quite an interesting history because he happens to chair the Financial Services Board of the G20. My own view of the way the G20 and the FSB started to think about these things in the immediate aftermath of the crisis is it was really smart, but the reality is everybody has been dragged off by their regional and domestic politics ever since. This is one of the least worst areas, in my view.

Q14 John Thurso: Sir Nigel, is there anything from your side that you think we should be watching out for or do you concur with those two?

Sir Nigel Wicks: I do not disagree with my two colleagues, but I have two quick comments. Liikanen was a report to the Commission. It was produced several months ago and so far there has been no formal response from the Commission.

Q15 John Thurso: Let me ask you then: what do you think is going to happen?

Sir Nigel Wicks: Well, probably very little. I think we will get some piece of paper from the Commission before the European parliamentary elections. I would be doubtful whether we will get a fully worked out proposal in the formal sense from this Commission, which finishes in about a year's time. Or, if they do produce it, it will then be the responsibility

of another Commission to carry it forward and that is going to create considerable uncertainty.

Secondly, already we have seen in Germany and France the introduction of various mechanisms that go in the direction of Liikanen but are not as strong. I am still unconvinced that we will see, as a formal finishing proposal, the full Liikanen approach. I am still unconvinced. We may; we may not. It could be made compatible with what is coming out of the Banking Reform Bill, but I saw some comments the other day, which I think there is some force to, that if you compare what we are doing here in the UK, what they have done so far in France and in Germany, and what has happened with Dodd-Frank, probably what we have done in the UK is more restrictive than elsewhere.

Q16 Andrea Leadsom: The new Governor of the Bank of England has made very clear his support for the single supervisory mechanism and for the reforms that will effectively mean that European banks are either supervised by the PRA and the Bank of England or by the European Central Bank. I would like to know from each of you whether you believe that there are risks to Britain's financial services from, effectively, one very large alternative supervisor to the Bank of England for the banking sector.

Jim O'Neill: I regard myself as not the most informed human being on aspects of this topic, but it never stops me talking about other things. First of all, I would say as a general thing—I guess we will get into banking reform more broadly—I am not sure still whether Germany is going to fully embrace aspects of this. I think they are quite resistant to many issues about European banking reform, including the role the ECB would play.

Andrea Leadsom: Yes, I want to get on to that, but I am specifically asking—

Jim O'Neill: Pass on, yes.

Andrea Leadsom: Perhaps Sir Nigel might be better placed to answer that question.

Sir Nigel Wicks: Let me answer your question with a very short phrase, which is yes, there are risks. Let me very briefly elaborate. First of all, I think the Government did a good job some several months back when they agreed a new voting mechanism for the EBA, the European Banking Authority. That was a good day's work and helpful.

If you do not mind me quoting something very short from a speech that Andrea Enria, who is the chairperson of the European Banking Authority, made last week in Brussels, it goes directly to your question. He said, "We are still facing a risk that the repair of the single market will proceed with different speed and will be driven by different priorities within and outside the SSM jurisdiction. We cannot rule out the possibility that a rift opens up in the single market between member states adhering to the SSM and SRM, and those that continue to rely on national tools for supervision and resolution. Only by maintaining an attentive focus on common rules—the single rulebook—common supervisory practices, strong mechanisms for supervisory co-operation and joint decisions, and especially joined-up approaches to resolution, will we be able to contain the risk of a split two-tier system and restore the functioning of the single market as a whole." Now, I think that they are very wise words. I agree with them and that is, I hope, an answer to your question.

Q17 Andrea Leadsom: What should Mark Carney and/or George Osborne be doing to address that concern?

Sir Nigel Wicks: For one thing, I would hope that the authorities in Europe are worried about that concern. There are certain people in the Commission who are worried and, judging by what I have just read out, the chairperson of the EBA is concerned. What should we be doing? All the relevant public authorities from the Prime Minister, the Chancellor of the Exchequer, the Governor of the Bank of England, PRA, FCA, and so on should fall over backwards within a strict definition of our national interest to co-operate, to have the right tone and to give the impression that we are here to make it all work rather than to throw spanners in the works.

Q18 Andrea Leadsom: Okay. Should Britain join the European banking union?

Sir Nigel Wicks: At the moment, most definitely no, and that is for two reasons.

Q19 Andrea Leadsom: Why?

Sir Nigel Wicks: Firstly, governance. The SSM, the supervisory mechanism, is effectively under the ultimate control of the governing council of the ECB. For good reason we are not members of the governing council of the ECB and since that is the case, since we are not part of the overall control, it would be wrong for us to be a member of the SSM.

Secondly, the supervisory decisions can in certain circumstances have fiscal consequences. We all want to avoid banks having to rely on the taxpayer, but you cannot get rid of the possibility in extremity. Under existing arrangements, if we were part of the SSM, and technically we could, it is not at all clear who would be responsible for the fiscal consequences arising from not only problems in this country but problems in other countries. Until that was sorted out, I do not think we should go near it.

Q20 Andrea Leadsom: Do you agree that there is, however, a residual risk, quite apart from the existence of the SSM there and not here, from the fact that European banking union is far from completed? For example, we had the situation with the Cyprus banks only recently where, in effect, the British taxpayer had to bail out the customer depositors in Cyprus bank branches in London while the ECB decided to haircut all customer deposits in Cyprus. Specifically, is it essential that European banking union is completed and what steps do you believe need to be taken in order for that to be finalised?

Sir Nigel Wicks: Well, I am not an absolute expert on what happened with Cyprus and whether it was branches that were bailed out or subsidiaries. If it was subsidiaries, that is what normally happens with the deposit guarantee scheme. I do not know whether branches were involved as well.

No, I come back to my main point. You have to be absolutely clear if a bank gets into resolution who it is bears the costs. To put it rather simply, it is the shareholders; it is junior debt holders; it is senior debt holders. The insured depositors—£85,000 here, €100,000 on the continent—are protected by deposit guarantee schemes and that is how it should be.

Q21 Andrea Leadsom: In your role as Chairman of the BBA, are you concerned that the lack of a resolution mechanism within the European banking union to date has a huge potential contagion effect for British banks?

Sir Nigel Wicks: No, I am not concerned about that. They have set up the supervisory mechanism. That is going ahead.

Andrea Leadsom: But without a resolution mechanism.

Sir Nigel Wicks: Now they are working on a resolution mechanism. This is a matter for them. We will want to make sure that that resolution mechanism, and I think this is possible, does not impinge on banks in London.

Q22 Andrea Leadsom: Would you accept that were there to be, say, a Greek or a Spanish or a German or a French banking crisis, the contagion to British banks who have debt of those banks or who have credit in some way, trading positions and so on with those banks, could be enormous without a means of resolution?

Sir Nigel Wicks: If one of those banks got into problems, there would need to be a proper resolution mechanism, but my judgment is that, compared to, say, three or four years ago, the sort of circumstances that you describe in your question are much less likely to arise.

Q23 Andrea Leadsom: Your answer is really that it is not going to happen rather than that there are measures in place to resolve it if it does happen?

Sir Nigel Wicks: I am never going to say in this world it is not going to happen, because a lot of people said that five, six, seven years ago and we did see it happening.

Q24 Andrea Leadsom: Exactly, yes. Let us say that your estimate that it is not going to happen is wrong and so it does happen; there is a systemic banking crisis in one of the eurozone countries. Would you then accept that there are massive contagion risks for Britain?

Sir Nigel Wicks: There are possible contagion risks when any bank goes down. There are risks.

Q25 Andrea Leadsom: No, I am talking about systemic, not an individual bank due to its bad debt profile. I am talking about systemic risk in a particular country where, let us say, all of a country's banks come under systemic pressures and the contagion effects on Britain.

Sir Nigel Wicks: No. For example, we saw it in the Greek case and the Cypriot case. Most of their banks were in real trouble. By that time, most of the British banks had reduced their unsecuritised lending to those banks of those countries. Banks had taken steps to protect themselves. The sort of disaster scenario that you are talking about I think is unlikely.

Q26 Andrea Leadsom: I am just saying to you I accept your opinion is it is not going to happen but, if it does, is there a significant risk of contagion to British banks under the single supervisory mechanism or isn't there? I accept it is unlikely, but if it happens what is the risk to the British banking system of contagion?

Sir Nigel Wicks: First of all, the single supervisory mechanism is not yet up and working, and I think there are other issues regarding the single supervisory mechanism besides the one that we were talking about. I certainly think that a more effective single supervisory mechanism and single resolution mechanism will reduce the risks that you are talking about.

Q27 Andrea Leadsom: Yes, okay, but we have just accepted that there is not a resolution mechanism.

Sir Nigel Wicks: Yet.

Andrea Leadsom: There is not one, and bearing in mind European banking union is not complete—we have a single supervisor but we have no resolution mechanism—what I am asking you is to suspend judgment on whether it is going to happen or not. I am asking you: if it does happen is there a huge risk of contagion to the British banking system?

Sir Nigel Wicks: Dr Lyons may have a view here as well. I do not see anything intrinsic within the single resolution mechanism or the SSM that will lead to the conclusion that you draw.

Andrea Leadsom: Yes, Dr Lyons?

Dr Lyons: Sir Nigel said it all, I think, but just to reiterate the point, coming back to your questions, three things. Firstly, whatever we think about the banking union and the eurozone, we need to be encouraging both of them to be successful and to be completed, and the eurozone to minimise macroeconomic contagion risks to the UK. For the banking union the fiscal issue has been mentioned. That is important to minimise any financial risk to the UK.

What can we do? The resolution scheme and the relationship we have with the EZ becomes the issue for us. At the end of the day, you can construct a plausible downside scenario, more macroeconomic rather than linked to the supervisory resolution scheme that causes the problem, but whatever happens on the continent we need to make sure we are resilient in the face of shocks. That comes back to the whole macroeconomic framework. The questioning that you were following, yes, if there was a risk, yes, there is contagion to the UK, but I could easily give you a plausible, very positive upside scenario based on macroeconomic criteria from the rest of the world, so we need to keep this in context.

Q28 Andrea Leadsom: Yes, but what I am trying to get at is, worst case scenario, there is a European banking union where there is a supervisor but no means of resolution.

Dr Lyons: Yes, they need to sort that out.

Q29 Andrea Leadsom: I am asking you: is it in Britain's essential national interest that they complete banking union? It is a simple question.

Dr Lyons: Yes. Sorry, the first point I was trying to make is from our national interests it is important that the eurozone is successful to maximise the macroeconomic upside, hopefully, but to minimise any macroeconomic contagion. From a financial/banking

sector, it is important for us that they complete their banking union to minimise any contagion to the UK. That is up to them, but they need to take the fiscal steps. Whatever they do, we need to then have that right relationship as well as being pretty resilient in the face of shocks.

Andrea Leadsom: Just one final question.

Chair: Very, very quick.

Dr Lyons: Sorry, Jim wanted to come in here.

Q30 Andrea Leadsom: I just want to pin this down. Mr O'Neill, if you were advising the Chancellor, would you be saying to him, "It is essential to Britain's financial services that we press the European banking union to be completed in double quick time," or is it not essential to Britain's national interest?

Jim O'Neill: Well, on that question I would say it is essential to make sure it is done right as opposed to the speed at which it is done. The point I was going to make in terms of systematic risk is that, irrelevant of any of these things, if for some reason Italy were to have a major financial crisis there would be considerable systematic risk to us and many others around the world. To go down the path of thinking, "If we get all this stuff done brilliantly it means there is no risk of contagion," I think would be a very grave error.

Chair: Good, I think we have had an answer to that. It has taken a while but it is very interesting.

Q31 Mr Love: Mr Mann made the observation that your answers were predicated on the basis that we would stay within the European Union. I want to come to questions around that. Looking at it from a financial services perspective, is there any merit in going down the Swiss or the Norwegian routes and having a different relationship with the EU?

Dr Lyons: I think the ideal scenario would be to remain within the European Union and see a reformed EU. My answer to your question would be almost like a four-sector diagram. Hopefully I can picture it. People always talk about "in versus out". If you put that on one side, but if you put at the top "reform" and "not reform", the top "reform" versus "not reform" is often overlooked in this debate and is key. People focus almost too much, or exclusively rather, on the in versus out. The ideal would be in and reformed, but in and not reformed might well be where we turn up to be: the status quo. If we leave and we are in the out and we do not reform, that is not good. If we are out and we continue to reform—reform our economy, our financial sector—then it is possible to see the City of London still being successful. It will probably not be the optimal situation. I would argue it would be more successful within a reformed EU.

Coming back to your specific question, Mr Love, if we were outside and if we were continuing to reform, i.e. move with the times, having a good relationship with the EU from an outside perspective and also positioning ourselves in the changing global economy, then it is possible to see the City of London still being successful. It is not only dependent on being in the EU, but I would argue the most important thing that we should press for—and because this would be in our best interests—would be to remain in the EU and to see the financial sector remain Europe's financial sector and to reform. Even if we are in the EU and reforming, we still have to make sure our relationship with the eurozone members, not being a member of the eurozone, is clear and works in our best interests.

Q32 Mr Love: Sir Nigel, if we take that answer just given, following either the Norwegian or the Swiss model and being outside, would we have any influence over that reform agenda?

Sir Nigel Wicks: I have to say I entirely agree with you. It is difficult, Mr Love, to gauge exactly the opinion of the international banks in London. My fairly well-informed view is that they want to remain a part of the single financial market and they want to remain in a position where they can influence the development of the single financial market, the regulations or directives as they come through. Because many of the banks and senior people are from other countries, they will not get involved in the argument about whether we should stay in or stay out. When constitutional issues are being discussed in countries, often the people in neighbouring countries are reluctant to say what should happen. They say it is a matter for the people of that country. That is the view that many of the banks take about the general question of in and out, but they are clear on the point about the single market.

To answer your question about the Norwegian and the Swiss models, for various reasons I think neither model would be a very good idea. Indeed, I think both would have very significant disadvantages. They would still make us subject to certain aspects of EU law but give us no influence about the development of that EU law. When it comes down to it, you are either in or you are out.

Q33 Mr Love: You have all gone on quite a lot about the single market and financial services being very important. You mentioned it in relation to international banks. Membership of EFTA gives us access to the single market. It does not give us any power to influence the reform agenda, but it gives us access. In certain circumstances where the reform agenda has stalled, we keep hearing about the problems that are going to arise over banking union. Would there be an occasion in the future where we might say the reform agenda has stalled; we are better on the outside rather than the inside?

Jim O'Neill: I guess my views have moved through time, and this is partly why I reminded you at the start I was no longer at Goldman Sachs. Most human beings have a very static view of life, but the world is evolving dramatically, including trade and financial relationships. While even in manufacturing and everything else the EU is our biggest percentage partner, in terms of the rate of change it is increasingly less important. Going back to what I said about the advantages we have, the City of London is beautifully placed to be the major financial services centre for the world. In the interests of that and what it contributes to the UK, which is substantial, we should not be constrained by dumb reform or the absence of it in Brussels or elsewhere. I believe that if it is increasingly the case that we should, we should not be so scared of exploring a world without it because the opportunities that are arising from the dramatically changing world are huge. I do not think quite a lot of people in our area, never mind just people in Brussels, either are that interested or understand it.

Dr Lyons: Yes, I would just like to reinforce that. I was involved in the No Campaign. We were told if we did not join the euro it would be disastrous for the City of London. We did not join the euro and the City of London did do well. Now, admittedly, the EU debate is very different to the euro debate itself, hence the point I made: ideally we should stay in. I agree with Jim and it is a point I made earlier. This should be about repositioning Europe,

including the UK, in the changing global economy. The rest of the world is really moving on. The pace and scale of change, the catch-up potential around the world, is key. We need to be thinking about not only a strong position of London and the UK within Europe but a strong position of London and the UK in the global picture. Ideally, we do that as part of the EU, but if the British people voted to leave, then I still think we can make a success of it whatever happens.

Q34 Mr Love: Perhaps I can ask Sir Nigel whether he agrees with that: in essence, the City is strong enough to survive whether we are in or out and, whether there might be some modest advantages of being in, we could easily survive with the changing world economy that we are seeing at the present time.

Sir Nigel Wicks: First of all, let me say where I agree with my colleagues, and that is the world outside Europe is changing at a rapid rate. The world that we see now and the world as it is likely to be in 20 or 30 years in terms of economic influence and power balance will be very different. The key for us in this country is to position ourselves where we still have influence there—that is a bit Foreign Office speak but I still think it is important—but also where we are able to put the country in a position where the people of this country can have a good living out of that. That is what we need to do.

I am of the view that we are more likely to be able to do that as continuing members of the European Union. I believe that if we are continuing members of the European Union it is more likely that the European Union will reform itself. As came out of discussion earlier, we do have many friends, many colleague member states, who would like reform. We are a big member state. We are a member state with a lot of influence, and as wholehearted members of the European Union I think we will stand a better chance of reforming the European Union, which is not only in the interests of the rest of the European Union, it is in the interests of us. I start on the basis that I want us to remain.

Dr Lyons: I agree with that. Just so that everything is covered, if we were to go down the other path of leaving, the transaction costs would be significant. The uncertainty would be significant and also the importance of Article 50 under the Lisbon Treaty is the key thing as well. The future relationship between the UK and the euro area would then have to be determined. Just reiterating the points we have made before, I agree with your scenario.

Mr Love: Let me just press you with one final question now.

Chair: One quick final question and a quick reply, please, because I am bringing in Pat McFadden in a moment.

Q35 Mr Love: Dr Lyons, you mentioned earlier the change in the voting structure. We have talked in some detail about the difficulties of achieving a banking union. There is a lot of talk about the Anglo-Saxon model not having worked and quite a lot of antagonism at a European level. Will we reach a point where it does become a choice of leaving because we are not influencing the reform agenda and, therefore, it would be better in the future circumstances with the world economy for us to be on the outside?

Dr Lyons: I could construct for you lots of plausible scenarios. The issue at the moment is that we are still in a post-crisis situation in Europe. The rest of the world is starting to grow strongly. The IMF talked about a three-speed world. In reality, we will probably have a multi-speed world, but the fast lane is the emerging economies, albeit slow but still

fast lane. The middle lane is now the US. The slow lane is still Europe and the UK, but we are likely to gather speed. A lot of the tensions, shall we say, are heavily influenced by the macroeconomic environment. As the macroeconomic environment improves in Europe, as I think it will, then that should ease some of these tensions.

Look, in a nutshell, I think it is about repositioning ourselves. As Sir Nigel touched on, if we can make the EU reform that is the ideal scenario. I could construct a scenario where we leave because the British people vote to leave. If that happens, then we need to very much think hard and fast about what we need to do and reform.

To conclude, if we had a referendum, a “yes” vote is as important as a “no” vote because what I hear in the City is that people do not think that we engage as well as we should do strategically in Europe. We need to be doing that more. Clearly, if there is a “no” vote, then we would know what needs to be done.

Chair: We heard that point. I am going to bring in Pat and perhaps, Sir Nigel, you could add your point to what Pat is going to ask.

Q36 Mr McFadden: I would love to continue this because one of the things that strikes me about this in/out global or European position is I do not see why it is a choice. I do not see why we cannot do two things at once, but I want to ask about other things just now.

To go back to the specifics of what the EU is proposing, one of the reasons we are having this session is we are going to visit Brussels in a couple of weeks to try to get a handle on that whole corpus of EU legislation that is coming down the track. PwC have talked of 29 legal texts currently being negotiated or expected to be tabled by the Commission in the near future. You, Mr O’Neill, have spoken in very diplomatic terms of an onslaught of regulatory nonsense, and there are 29. I would like to get a simple audit for us before we go of what we should be looking out for. I will start with you, Mr O’Neill, given that is your phrase. Of this whole terrain, can you tell us if you think there is anything good and in the UK’s interests in it? On the flipside, a bit like what John Mann asked you about, I am asking you to range a little bit wider than just one. What are the things we should be looking out for that you think are harmful to the UK’s interests?

Jim O’Neill: Just on Mr Love’s question, my view is it could. I can certainly see a situation where we might want to just go alone, and we should not be so scared about it, in my view. I would not have said that five years ago.

On this, good luck. I sit on the board of a European think tank, BRUEGEL, and have done since it was started. There are some times when I am at a board meeting where these issues come up and it is like Swahili, so good luck to you. You need PwC and others ahead of it to simplify it for you. There are clearly things that are being pursued that are not in the interests of the City of London’s role in the world and, therefore, its role for the UK; in particular, the financial transactions tax. The damage that would do to GDP in Europe, never mind elsewhere, is articulated by a host of independent entities. It could, in some ways that they are trying to execute it, cause the whole EMU crisis to flare up again, never mind anything else.

Q37 Mr McFadden: Do you think the damage to the UK that could be caused by some of these things is accidental collateral damage because people are just not taking into account UK interests, or do you think it is a targeting?

Jim O'Neill: I think there are two parts. Going back to what I tried to emphasise carefully at the start, quite a few of the member countries think about what role the banking sector plays for their own domestic economies. There might be things that we could learn as a nation about that, but that is distinct from the role the City is playing for the world and the service royalties. They do not think about that. They think much more about the first thing. They do not appreciate or even know or want to consider this huge role that the City plays for the UK and the world. In some countries' cases, I do not think it is conscious. It is certainly not a Brussels view but, of course, one of their own dilemmas is they are frequently influenced not by what they think but by what noisy voices inside the Council of Europe think. There may well be some of those that see it as quite a good thing to knock us down to size, so through that the EU is influenced, but not consciously.

Q38 Mr McFadden: It is not all bad, is it? For example, the Government has chosen to pursue the bail-in resolution thing through an EU directive, to my surprise. I am a bit surprised that this Government in particular is choosing to pursue that at an EU level, but they are. The argument for doing so is that some of these things require international rules and it makes sense to do it that way. Not all of these 29 pieces of legislation or proposals are against the interests of the UK.

Jim O'Neill: No, of course not. I do not know them all because, as I say, it is like Swahili, a lot of it. There is one that is probably very helpful, but I wanted to highlight the scale of the potential damage that the financial transactions tax could do. It is really dangerous.

Q39 Mr McFadden: Sir Nigel, in terms of your audit of the 29, what would you advise us that we should be supporting strongly or looking out for as potentially damaging?

Sir Nigel Wicks: I am going to answer that question specifically, but let me take your initial point about either/or Europe or global. I do not think it is either/or. I think it is Europe should help us be global. That is the way I would put it.

Can I very briefly, Mr Chairman, with your agreement, just take up this point about Anglo-Saxon capitalism being the reason that things got bad? Undoubtedly, things have gone wrong in the Anglo-Saxon capital markets, but the Spanish caixa banks did not get into problems because of Anglo-Saxon capitalism. The Greek banks and the Cypriot banks did not get into problems because of Anglo-Saxon capitalism. You look at many of the banks in this country, including the nationalised ones. Why did they get into trouble? It was not Anglo-Saxon capitalism, it was bad lending. While I am not necessarily a defender of everything that goes on under the heading of Anglo-Saxon capitalism—and, by the way, I make a very great distinction between Anglo-Saxon capitalism this side of the Atlantic and the other side of the Atlantic—I am not one of the people who accept for one moment that Anglo-Saxon capitalism is causing all the financial and economic ills we have.

To go on to your point asking the question which one we should support, I think the bank resolution and recovery directive is absolutely a key one. This is different from the resolution mechanism that I was discussing with Ms Leadsom because that applies just to

the euro area. This one applies to the lot. Logically, we should have started off with the bank resolution and recovery measure. That is the key one. What happens if banks get into a muddle and something has to happen? How can we put ourselves in a position such that the taxpayer is not called in to bail them out and the essential services offered by those banks continue? Discussions are going on virtually as we speak in Brussels about this directive. It is dragging on but it is important that it is finalised before the end of this Parliament and the end of this Commission because if it spills over I do not think they have the mechanism—

Q40 Mr McFadden: What is your betting? If you were going into Ladbrokes to put your tenner on, what do you think?

Sir Nigel Wicks: I am not a betting man. I worked for a long time in the Treasury and you were forbidden to bet, so I am not a betting man with Ladbrokes. There is a good prospect that it will get through, but it needs someone putting shoulders to the wheel. I am sure that Commissioner Barnier wants to get it through, but we really have to get it through.

Q41 Mr McFadden: Should we not be doing this ourselves in the UK, given the size of our financial sector and given the strong public interest there is in the taxpayer not being on the hook for future bank failures?

Sir Nigel Wicks: We can do it for our own banks, and we have done it. We have a special banking resolution mechanism that was introduced some time ago and that seems to have worked. But these banks, as the point came out earlier on, are all subject to contagion and they all operate cross-border. In our region of the world, which is Europe, we really do need some common rules, common understandings, about how it should be done. The BRRD, the bank resolution and recovery directive, does start to put those common rules into place.

One final point, which I have not heard often made: competition policy is determined in the European Union at European Union level. It is not only determined, but it is implemented at European Union level. Competition policy is something that impinges very much on national sovereignty. We have seen that as a result of some bank rescues, the Brussels Commissioner Almunia has said, “Go ahead, but you have to divest them service by service.” It works. It basically works and is quite reasonable. There is not much challenge.

We have to get ourselves in the same position where we have a mechanism that works efficiently and fairly when it comes to bank resolution and recovery, and that should be at the top of the agenda.

Dr Lyons: A lot of the points have been made. I think we basically need to do what is right for the economy and protect the taxpayer. Competition I think is a key part. My concern about the regulatory pendulum as such is that if it swings too far it impinges on competition because the regulatory burden stops new entrants. Even though we are talking about the financial crisis, the City of London did remarkably well. What we really had was a banking crisis. If you look outside the banking sector, the City did do well.

Coming back to your question, I think it is a more generic one. It is about the future relationship between the eurozone and the non-eurozone. That is the key thing that I think we need to be clear about and make sure that works properly.

Q42 Mr Ruffley: Sir Nigel, you, the BBA, have called for the European Commission to be mandated to pursue global convergence of financial services policy. What are the chances of that being supported?

Sir Nigel Wicks: We sent out—and I think this is probably what you are speaking to—a little document not too long ago, headed, “Beyond the Boundaries: How to drive regulatory coherence”. We wrote that because there is what is called balkanisation in the global financial markets, referred to earlier. Every member state, the United States, everyone is doing their own thing. That is not efficient in terms of regulators; it is not efficient in terms of properly working markets. The purpose of this was to suggest that something should be done about it.

Which body is responsible for doing something about it and where would I lay the particular duty? It would be under the global FSB, under our own Governor of the Bank of England, who is chairman of it. I think the Commission have done a reasonable job in following up and implementing—sometimes we disagree how we implement it—the original Financial Stability Board recommendations, which came from G20. I would therefore urge the Financial Stability Board to get cracking here. I think I am really pushing on a door that is already three-quarters open, because if you look at their last documents they recognise it. If they take it up, get it endorsed at G20 level—it will probably be the new Commission rather than the old Commission—I would expect the new Commission to take a good deal of notice of what comes from that global body.

Q43 Mr Ruffley: Would it not cut across the powers of the Commissioners?

Sir Nigel Wicks: When you talk about the powers of the Commissioners—

Mr Ruffley: Monsieur Barnier, for instance.

Sir Nigel Wicks: Monsieur Barnier’s main powers are to propose legislation. That is his main power. The Commission does have some powers. It has some powers of execution. Personally I think that is a mistake. The big debate going on now is whether the Commission should have the final say under the single resolution mechanism. The Council say, “It should be us,” but there are legal reasons that may point in the Commission’s area.

If the Financial Stability Board, the world global one, points sufficient authority in the right direction, I would expect the Commission to pick it up, just as Monsieur Barnier picked up the original mandates from the G20.

Mr Ruffley: So it is a runner?

Sir Nigel Wicks: It is a runner.

Q44 Mr Ruffley: Staying with you, Sir Nigel, on the bonus cap, the PRA has said there is little or no ex-ante evidence that the proposed cap on variable remuneration will be net beneficial. Where do you think we are? Obviously there is a legal case in train at the moment, but where do you think that is going to end up, from the City of London’s point of view?

Sir Nigel Wicks: There was talk earlier on about unintended consequences, and one unintended consequence of the bonus cap arrangements has been to increase the base salary, the fixed salary, which bankers will get virtually on the nail straight away.

Q45 Mr Ruffley: I understand that but I am thinking of the politics.

Sir Nigel Wicks: The politics of it are that at the moment there is a suggestion, something coming out of the EBA, that some 30,000 so-called critical decision-makers will be caught, which is absurd. You should not catch 30,000. I think there is a very good chance that will be modified. I do not know, not being a lawyer, what the results of the legal case will be. A personal view, not shared by the banks, is that quite frankly they should have done it totally differently. What they should have done is they should have said all bonuses should be paid in bail-inable capital.

If all bonuses were paid in bail-inable capital, it would really give a much better incentive on senior executives to avoid being bailed in. That would have been aligning regulators' interests with what the senior management are.

Q46 Mr Ruffley: Could I move to Dr Lyons and the FTT? If the 11 EU members who have signed up to this go ahead with it—let us for the purposes of this discussion assume that we win our legal case and we can not join—would that in economic terms be a positive for the City of London or a negative for the City of London, or would it be neutral and not make any difference?

Dr Lyons: I am not sure, is the answer. My immediate reaction is it would be neutral to positive, but given that the City is the financial centre of Europe, if the City is not going to have the tax then what happens on the continent should have marginal positive impact.

I think the wider issue is the legal aspect, which comes back to some of the points we were touching on earlier. It seems that more and more issues are now being determined on the legal front. The good thing is the UK has legal recourse to challenge or question regulations it does not agree with. The question is whether the ECJ is going to always side with the wider EU or with the eurozone in the future or whether each different case is going to be determined on its own merits. It comes back to the wider issue about remaining outside the eurozone but making sure the single market works properly.

Sir Nigel Wicks: Can I just answer that question as well? I think, quite frankly, if they go ahead with it, it is possible there may be some marginal advantage as business comes to the City, but I think if they went ahead with it, they would screw up their own economies. Since they would screw up their own economies and make their own economies not work well, and since we export to those economies and depend on the prosperity of those economies, I would not be at all surprised if the overall effect on the UK economy would be negative.

Dr Lyons: Yes, on those marginal terms. The wider economic issue is that they need to boost demand.

Q47 Mr Ruffley: Do you think the FTT would have any effect, Dr Lyons, on the real economy, not just City institutions—borrowing costs, for instance? Would it have any material impact on that, do you think?

Dr Lyons: There are two issues here. One is the statement of intent and one is the actual level it is imposed at. A statement of intent, if it was seen that we are now going to go down a further path of taxation, albeit in this area, might have a direct and indirect impact in terms of competitiveness or people's thinking. I think the second point is also

important, which is the level. The financial transactions tax, as I understand it, would be imposed at a pretty minimal rate.

It comes back to something Sir Nigel was talking about earlier about balkanisation, and it is the need to look at all this in the global picture. Certainly the global picture Jim and I were talking about earlier in macroeconomic terms is a real positive in terms of the size of the global economic cake. In terms of the financial sector, it is to avoid the unintended consequences, or the balkanisation.

If you had a statement of intent and people thought London might eventually be impacted, then that could favour other financial centres. Bringing it all together, I would not overstate the financial transactions tax at the moment, both because I do not think it will be imposed in London and also it looks like it will be relatively small if it is imposed on the continent. But we have to watch this space.

Q48 Mr Ruffley: Are you picking up that the Germans have concerns about the possible design of the FTT?

Dr Lyons: I don't know about that point.

Mr Ruffley: Dr O'Neill?

Jim O'Neill: On all the things you said?

Mr Ruffley: On the FTT specifically.

Jim O'Neill: As I mentioned earlier, I think the whole thing is close to insanity. It would definitely negatively impact the eurozone's own economies. If applied as generally proposed, without getting too technical about it, the marginal influence of things like repaying of bonds, it could be a nightmare for some of the peripheral European bond markets that have recovered in the past 12 months and push them even more into an deflationary situation than they currently are. I think it is surprising how there has not been more thought about that in some of the countries that seem to be most vociferous in favour. It is to be hoped, in my opinion, that we would win that legal case. We would get a bigger slice of a smaller total pie.

On the German situation, it was very clear to me that the German authorities are not supportive really of it, or the previous CDU coalition was not. I would have some concerns that one of the costs of this coalition may be a shift in stance.

Q49 Mr Ruffley: Staying with you, Dr O'Neill, one of the arguments is that it primarily targets high frequency trading and short-term trading. Assuming, worst case, the FTT does somehow get imposed on this country—who knows, there might be a change in British Government in 2015 and they might be more open to bashing the bankers—is London's position as a prime financial market dependent on short-term, high frequency trading, as the proponents of FTT seem to suggest?

Jim O'Neill: I would have a different view than others that I have seen maybe sit in this room and articulate on aspects of this. I think it is, from my experience, a bit dangerous to try to distinguish between high frequency trading for the sake of high frequency trading and what that does for the ease of other substantive and necessary things, such as financing Government bonds. I think it is really a very naïve view to try to separate out unintended consequences. I think it could be very harmful.

I said two things at the start. I think I mentioned again about what we have. A 2% surplus of GDP that the City creates, effectively, for the balance of payments for the past 30 years would be vulnerable. While I do not personally believe there are continental European centres that could provide some of these services, some highly mobile global firms could consider doing some of these things more from New York than they do from London, or they would explore other jurisdictions around the world that, as I am sure you are very aware, in the past three years are offering tax incentives to do so anyhow. So I think it could be highly damaging.

Q50 Mr Ruffley: Could I ask one final question? You did a very interesting article about a year ago now, where you extrapolated German export patterns towards 2013 to 2020. I think you said that if it carries on at the rate of the preceding 10 years, China would be an export destination for Germany, twice as big as France. In that, you also said Britain would be different in that respect. You seemed to imply we would have difficulty if we wanted to try to change our trading patterns. I think it was in the context of Britain leaving the European Union.

Could you just say a bit more about that, about how, if Britain did leave the European Union and was outside the single market, what its future would look like? It would presumably have to construct new trading patterns pretty smartly, pretty quickly.

Jim O'Neill: Two things about that, because I am doing a lot of work on this topic in my new life. The change in world trade that is taking place is unheard of for multiple generations, so any organisational structure that assumes status quo is in trouble. One of the problems about the EU and many of its members is they seem to live in a very status quo environment.

The very latest evidence shows that German export growth to China has slowed considerably, so if we were to focus more on the very latest trend as opposed to the past decade, China won't be double to France, but it will definitely be bigger. Without a catastrophe in China, it looks quite likely to me that China will be Germany's number one export market.

The second thing to say, which leads me to be a bit more enthused, and partly why I answered the way I did to you, is if you look at what I would call the new China, which the latest plan is giving a lot of emphasis and is moving more aggressively toward, if not online even more, I think the UK might be better positioned to accelerate its export growth to that new China than the old China, because of the nature of the sorts of things they are trying to encourage—rather than capital goods, value-added consumer products, including broad services. They play more to the advantages, which is why this issue is so important for us.

Mr Ruffley: Financial services?

Jim O'Neill: Including financial services. Not only financial, but including financial services but other services too. Educational services, I would say.

Dr Lyons: I think we should be incredibly positive about the global economy. I think the global economy is going to really do fantastically well over the next almost 25 years. That is despite incredible near-term challenges and uncertainty. If you sit looking at things from a European perspective, you can think we are in a very difficult situation because demand

is weak, lending is weak and confidence is weak. If you jump on a plane to the other side of the world, things look very different. I was out in China a few weeks ago with the mayor and I am going out next week when the Prime Minister is out there. I think it is vital that Britain really positions itself in China.

The good thing is that the next stage of development in China is not immediate. It favours Britain in one respect if we play our cards right. At the moment Germany is really well positioned. Germany is benefiting from the global infrastructure boom, the global manufacturing boom, but business, professional, legal, banking services and so on should do well as emerging economies, China included, develop their financial markets. That is important. If London becomes an offshore centre for the R&B, that is important. All of these are key.

Also I think it is important that here in the UK we recognise that anything that really damages the City does have negative impact not just for the London economy but potentially the UK economy. If you look at the latest state of financial and insurance services, they are almost 21% of the London economy. London is about a quarter of the UK economy. The European Commission earlier this year came out with their most competitive regions in Europe. What was interesting is that three of those are in the south of the UK. Bedfordshire, Berkshire and Oxfordshire were fifth place; Surrey and Sussex were in third place. I would argue that is because London was in second place. So the competitiveness angle is key but of course we need other parts of the UK economy to be doing well, hence your City issue. The gist of it is that we are all in it together. Coming back to the earlier point, it is about positioning Europe as well as the UK in this global economy.

Chair: Andy Love, do you want to come back with one quick question?

Q51 Mr Love: One quick question. I am not sure we will get a quick answer, but a quick question. It is really to go back to the issues that I was talking about earlier on and seeking clarification, because financial services is the most successful industry in the UK and people will want to know, if I can call you the experts, what your view is.

Sir Nigel, you seem to be suggesting that your membership, particularly international membership, would be very reluctant to get drawn into giving a view. Dr Lyons, you were suggesting that, whether or not within the European Community, the City will thrive. Mr O'Neill, you were suggesting that the developments of the international economy were such that we could be relaxed about Europe and whether we were in or not. I was wanting to get a view, a clarification, of what the impact on financial services would be, because I think we owe that to the British people who will have to take this decision.

Chair: That is not your quickest ever question. Let's see if Gerard Lyons can give us one of his quicker answers.

Dr Lyons: The impact on the financial sector of the EU debate? I am currently doing a report for the Mayor of London, Boris Johnson, on this, hopefully out in the New Year. Without giving secrets away, because it is still work in motion, the ideal situation for the City would be to remain in a reformed EU.

Mr Love: There's a surprise.

Dr Lyons: I come back to my very first comments: there is a difference of opinion. The retail sector tends to say, from what I can make out, they would do okay outside of the

European Union. That is because there are lots of positives already in place. But if the British people decided to leave, then, just as not joining the euro did not prove to be the complete disaster that the consensus thought, this need not prove to be a complete disaster.

If we left and didn't reform, didn't position ourselves properly and didn't have a good relationship with Europe, that would be very negative. If we left and positioned ourselves in the changing global economy, we could do well. There would be transition costs; there would be tremendous uncertainty. It is not a done deal that we would succeed.

In a nutshell, coming back to a four-sector diagram, it is not just in and out, it is also reform versus not reform. In, with reform, is the ideal situation. Outside and reforming could be a good second best.

Chair: Mr O'Neill, could you do better than that, time-wise?

Jim O'Neill: I would not say I would be very relaxed, but my answer would be to be bold, be global and don't worry so much.

Sir Nigel Wicks: My view is that the great majority of foreign firms, foreign banks in London, want us to remain full members of the single market and retain the ability to implement the development of the financial single market. That is what their view is. I would go on to add that on a personal basis there is no other way of doing that, that I can see, other than remaining full members of the EU.

Chair: Thank you very much, all three of you, for giving very interesting evidence. It became more and more interesting as the afternoon wore on, so we are very grateful.