



HOUSE OF LORDS

Revised transcript of evidence taken before

The Select Committee on the European Union

Financial Affairs Sub-Committee

Inquiry on

COMPLETING EUROPE'S ECONOMIC AND MONETARY UNION

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Questions 141 - 157

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1.15 pm

Witness: Mike Vercnocke

Members present

Baroness Falkner of Margravine (Chairman)
Lord Butler of Brockwell
Lord Davies of Stamford
Lord Haskins
Earl of Lindsay
Lord McFall of Alcluith
Lord Shutt of Greetland

Examination of Witness

Mike Vercnocke, Head of European Affairs, City of London

Q141 The Chairman: Mr Vercnocke, thank you for agreeing to give evidence to us today for our inquiry into completing Europe's economic and monetary union. As you know, this session is on the record and we will take a verbatim transcript of proceedings, which will be published in due course. You will have the opportunity to correct any minor errors or misunderstandings. I will kick off by asking you for your general overview of the Five Presidents' Report and indeed the Commission's follow-up proposals on 21 October. Do you think the report does enough to strengthen the euro and secure its long-term sustainability? Are there any omissions you think ought to be corrected? How do you see the priorities for the next phase of the process?

Mike Vercnocke: That is quite a big question. One thing I should say at the start is that the City of London's view, and of course I work for the City of London Corporation, is that we want the economic and monetary union to work and not be dysfunctional. It is to the benefit of everybody, not just the eurozone countries. Obviously it is a great benefit for them, but also for us and indeed for the City of London, if the eurozone works effectively. In that sense, we are quite supportive in principle of the Five Presidents' Report and the need to ensure that the monetary union works.

It was quite clear from the start that, for various political reasons, it was an imperfect monetary union. There is no way of getting around that. That was probably exacerbated by allowing too many countries in that were not really ready to join, but that is the past. I guess now they have to look at how to make it better. We are not overly sure the initial actions up to 2017 in the Five Presidents' Report will be able to make that much difference, partially because of the constraints of the treaty. The treaty has already been stretched to the limit by what they have done. As I am sure you are aware, there is considerable political opposition from some member states to certain aspects of the proposals for the next stage, for example

creating a euro treasury or joint representation at the IMF. These are things that the Commission has thought up but, as far as we are aware, a lot of member states do not really support those proposals at this stage.

We are looking, up to 2017, at some gradual attempts to make things work a little better. The trouble with that now is that, when the Five Presidents' Report came out, it looked possibly achievable. Events have made it much more difficult now, with all the problems with immigration, for example. I was in Paris last week talking to some of our French colleagues. The French Government are no longer really viewing austerity and the stability of the eurozone as a prime concern; they are now viewing defence and security as their prime concern. A lot of these actions are going to be blown out of the water by other things. In the short term, I do not really see huge changes. We will probably get on to the deposit insurance scheme and things of that sort a bit later.

In the longer term, after 2017, it seems to me the only realistic option is for some quite significant treaty changes to be proposed. The obvious areas are certainly on the governance of the eurozone and creating more legally binding mechanisms for imposing fiscal rules on the members of the eurozone. At the moment, although we have the six-pack and so forth, it is not really that effective. Certainly the proof of the pudding so far is that it has not been very effective. They will have to look at treaty change of that sort so, at the very top level, you are looking at some sort of fiscal union. That does not necessarily mean a complete union, but some sort of mutualisation of some of the risks and possibly some joint issuance of debt, for example, which the Commission has certainly been talking about since I have been in Brussels, which is a long time. Possibly lower down you might look at things like insolvency law and possibly even some form of taxation. I would emphasise that these are all big issues that probably do need to be tackled if the eurozone is to be fully efficient but, politically, they are very difficult not just for the UK but for a lot of members of the eurozone.

Lord Davies of Stamford: You could do insolvency law without a treaty change, could you not?

Mike Vercocke: You possibly could. It depends how detailed it is. The ECB certainly looked into whether you could do securities law, for example, so some sort of limited insolvency harmonisation for the financial sector or certain asset types, but it is still quite difficult and sensitive. Obviously in some countries insolvency law is enshrined in their common codes; therefore, a pretty big treaty change would be needed.

Lord Davies of Stamford: It may be extremely difficult, but it is possible within the treaty. That is my point; you do not need treaty change for it.

Mike Vercnocke: You probably do not.

Lord Davies of Stamford: If the political will is there, you can get it through in national legislation.

Mike Vercnocke: Yes, that is probably true. Of course, it probably would be easier if you had some sort of treaty change because, without it, it would be much more difficult for the Commission to convince everybody to make the changes.

The Chairman: Post 2017, particularly with two major countries' elections, do you see a dramatic change in gear?

Mike Vercnocke: That is very hard to judge. You are quite right. Obviously we have the federal elections coming up in Germany and then the presidential election in France, which is already a major topic of debate in Paris. A lot could change on the outcome of those elections. I would say yes. With the caveat that we get over all the current problems, if they are determined to make a real change to the eurozone from 2017, you would have to see some really major steps.

Lord Haskins: We face the issue of referenda in certain countries.

Mike Vercnocke: There are about nine countries, we reckon, so it could be quite difficult. This is exactly the thing: a lot of the things that the eurozone needs to do—and a lot of people know they need to do them—are nevertheless very difficult politically.

Q142 Earl of Lindsay: You have described the positive impact that should be enjoyed by the City of London, or its perception, from the completion of the monetary union. In terms of how it is completed, are there any negative or potentially negative impacts that you are aware of and we should be aware of? You might argue that, whilst there has not perhaps been reason in the past to develop a treaty decision-making or oversight process that leaves non-euro member states out in the cold, that could develop, in terms of how decisions surrounding the euro and euro member states are developed. Is this a concern and is it something that therefore should be safeguarded against?

Mike Vercnocke: The short answer is yes, absolutely. I would still say that getting the eurozone working efficiently is of benefit to us, but indeed there are potentially negative consequences that we would have to guard against. The obvious one is that, if you have a more cohesive eurozone, it is more likely that those members will vote together. We may already see that a little. We may come on to this later, but for EDIS, the European deposit insurance scheme, there is also a parallel work track looking at the reduction of risk in the financial sector, which applies to all 28. Of course, it is particularly important to the eurozone,

because of the single supervisory mechanism. There is already, possibly, a certain momentum to be more coherent, which in the past they have not really been.

You are right: there is a risk to all “out” member states that the eurozone might start to behave more as an entity and might take decisions that were of benefit to the eurozone but have negative consequences for the outs. For example, things like the ECB’s location policy have been avoided so far, but you could see that the eurozone might argue, for prudential reasons, that euro-dominated transactions should be cleared in the eurozone. That could potentially have a negative impact on the City of London.

Earl of Lindsay: In order to address that potential threat, do you see that the role of the United Kingdom in the governance process surrounding eurozone matters should be inclusive rather than exclusive? For instance, do you see us continuing to have a role on the Council in terms of the eurozone agenda?

Mike Vercnocke: I believe we need, or the outs need—and this is why we probably need a treaty change ultimately—a clear mechanism to regulate the relationship between those member states that are not in the eurozone and those that are. Obviously, as you know, at the moment the view of the Commission and the legal view is that, apart from us and the Danes, ultimately everybody is on a trajectory to be part of the eurozone eventually. We are now looking for a change to that, so that the euro is an option rather than a mandatory requirement of being a member of the European Union. That would then crystallise the situation where you have a single market, with some members not being in the eurozone on a potentially permanent basis. In that case, you need a mechanism to say how that relationship works.

It is going to be quite difficult. Any single market legislation will be for the 28 at any rate, but of course we have this problem of the eurozone potentially ganging up. You need some legally binding mechanism so that the non-participating member states have the ability to be in the process and possibly block actions taken by the eurozone, at least temporarily. That would need a treaty change.

Earl of Lindsay: Can I have just one last question? In that sense, is the Five Presidents’ Report, to your mind, more about the eurozone than it is about economic union and the single market?

Mike Vercnocke: Yes.

Earl of Lindsay: Is that a regret or was that inevitable?

Mike Vercnocke: It was probably inevitable. It is very clear when you are based in Brussels that the Commission’s view is the single market and the euro are one and the same thing. We tend to look at them as different buckets. They see very much that the euro is the currency of

the single market, the future of the single market is the euro and the two are inextricably linked. That needs to be challenged a little, because that may not be the future.

The Chairman: To pick up on that point, do you see any evidence of caucusing against the UK in eurozone circles and meetings?

Mike Vercnocke: No. We sometimes see caucusing against the financial sector.

The Chairman: We might even see some of that in the UK.

Mike Vercnocke: It is possibly justified. Sometimes we feel we are being “got at”, but when you look at it, it is not the UK part being got at; it is the financial sector as a whole. The point is that a large part of it is in London. It is still aimed at Deutsche Bank, BNP Paribas and Société Générale; it is just that those operations happen to be in London.

Q143 Lord Haskins: I know it is irrelevant, but where do we stand on the financial transactions tax?

Mike Vercnocke: The Belgians, with their newish Government, are getting increasingly cold feet about it. The Belgian finance minister, who is a Flemish nationalist, has made words to the effect that he is not so sure it is a good idea. They are coming very close to the minimum number of member states. You have to have nine member states for the enhanced co-operation process to continue, so it is looking very unlikely that anything will happen in the short term. The general view here is that it is very hard to kill it because so many people have put so much political capital into it, but equally there is no real will to make it happen.

Lord Haskins: Is that mainly from the Parliament?

Mike Vercnocke: Yes, the Parliament is certainly very much in favour of it, and some member states are. The Italians and Belgians were, but no longer. Belgium used to be a very strong supporter. In Germany, it is a very mixed view. As you know, the CDU and CSU really do not like the idea, but the SPD do. The coalition agreement was to continue with it. The other thing we have repeatedly made plain to everybody who listens is that, if you are looking for capital markets union and development of the capital markets and equity finance, the last thing you want is—

The Chairman: A variable financial transactions tax.

Mike Vercnocke: Yes.

Earl of Lindsay: If you say that the Five Presidents’ Report is principally about the eurozone agenda, rather than the single market or economic agenda, does that introduce a fundamental incompatibility between what one agenda is trying to achieve and what the second agenda should be wanting to achieve?

Mike Vercnocke: It is a possibility, but I would not say it necessarily has to be the case. From an economic point of view, what is good for the eurozone should be good for the single market as a whole. These political and governance issues are more difficult. The clear example is the creation of the single supervisory mechanism, which now supervises 129 major banks in the eurozone. From our discussions with firms, they think it is working rather well and has improved the overall prudential supervision across the European Union. Now you have the Bank of England doing a good job at one end and you have the ECB dealing with all the others, rather than having 28 supervisors all with different views. On the one hand, it creates a more powerful ECB. On the other hand, it seems to have made the market work more efficiently. We have to be on our guard, but it is not necessarily always the case that something done for the benefit of the eurozone is necessarily detrimental to the UK, but it could be, so we have to watch it.

Q144 Lord Davies of Stamford: Just on that one, if in fact it is the case, as you have just suggested, that having bank supervision organised on a 19-country basis has improved the situation, made it clearer, reduced costs and what have you, why would it not be better still if everybody joined banking union? What is in the British national interest that precludes our joining the banking union?

Mike Vercnocke: From the banks' point of view, a lot of major banks probably would agree that it would be better if they were all in the banking union. The issue at the moment, of course, is that the banking union is not purely about supervision. It potentially has some fiscal implications as well. Certainly if the European deposit insurance scheme flies, and that is coming under a lot of opposition from Germany and others, in effect you would have mutualisation of the risk. If a bank fails, the bail-out would be by all the participating members. For a country like the UK, which is not in the eurozone, that would have unacceptable fiscal implications.

Lord Davies of Stamford: If that went on in the eurozone, it does not increase the risk?

Mike Vercnocke: No, but it increases whether you pay or not.

Lord Davies of Stamford: The risk would be that a country in the system defaulted on its retail bank insurance obligations. That eventuality can arise whether we are part of the euro or whether we are not. It does not make it more likely if we are not in the euro. That does not make any sense. If we join that mutualisation arrangement, we are equally exposed to every other country that is in the mutuality arrangement.

Mike Vercnocke: Yes, but I presume we are not going to join that. If you are in the banking union, you will have to join the mutualisation of deposit protection.

Lord Davies of Stamford: That is the factor holding us back.

Mike Vercnocke: I am not the Government, but I would imagine so, yes.

Lord Davies of Stamford: Would you agree there are some quite important considerations on the other side of the balance sheet? One is compliance with this reform if there was just one set of supervision. Secondly, there would be no temptation or opportunities for regulatory arbitrage. Thirdly, the distinction between capital markets union and banking union is not a rigorous one. What about money market funds? What about shadow banking? What about securitisation of bank loans or the secondary market in CDOs? Is that banking or is it capital markets union? Do you agree with my points?

Mike Vercnocke: That I agree with, yes. You are absolutely right. There is no easy dividing line, but the advantage of the banking union at the moment is that the way the UK supervises its banks is very strong, but that has not always been the case across the rest of the European Union.

Lord Davies of Stamford: It is now with the ECB.

Mike Vercnocke: Exactly, so there has been a definite increase in the standard across the EU. Also, the assessment of the risks that banks are running is now much more comparable across countries whereas, in the past, clearly what the Banque de France thought was a risk and what the Belgian banking commission thought was a risk were not exactly the same.

Lord Davies of Stamford: We now have the same rules, which the EBA lays down for us all. Would you agree that most of the objections to our joining the banking union disappear? The one that remains is the mutualisation of risk.

Mike Vercnocke: That probably is the main one, but I do not speak for the Government, so I do not know.

Q145 The Chairman: On that point, leaving aside whether you agree that is the only thing holding us back, do you think the culture of the City of London would tolerate supervision from Frankfurt?

Mike Vercnocke: It depends on which part. Certainly at the moment, if you are looking at conduct-of-business rules, no. We are basically the only real wholesale international capital market in Europe, so that would not work. In terms of the prudential supervision of the banks, there are probably fewer obstacles, because the rules are pretty much the same and the banks are pretty much the same as well. From my point of view, there would be fewer difficulties in that. In terms of the capital markets, there would be much bigger difficulties, because there simply is not the expertise in any of the other member states to do that.

The Chairman: From your perspective, do you think the UK would be better off in a banking union?

Mike Vercnocke: There are pluses and minuses. The caveat would be: as long as the whole banking union is completed, because that is not yet the case. If it were, one advantage from the UK's point of view is this issue of too big to fail. While a bank may be too big for an individual member state to cover, it would not be too big for the whole of the European Union to cover. There is some advantage.

The Chairman: Bank resolution would become easier.

Mike Vercnocke: It would potentially become easier, yes. On the other hand, you would have less control over it, so it is swings and roundabouts.

The Chairman: Is the City of London thinking along these lines, as to whether the UK may be better off in banking union?

Mike Vercnocke: The City of London Corporation is not working on that, but I know that some of the companies have been, particularly those that are already partially supervised by the ECB. There are possibly concerns, though, that part of the work of the review for the EDIS is the reduction in risks in the banking sector. One of the areas that the Council working group is going to be looking at is a reduction in national derogations in the directives. That, in the current situation, could have difficulties, because that would reduce the flexibility that national supervisors could use. That might be something worth watching.

Q146 Lord Butler of Brockwell: May I ask you about capital markets union and what the City's view of that is? First of all, I imagine you welcome it. Is it making good progress?

Mike Vercnocke: Yes and more or less. Yes, we very much welcome Lord Hill's work on this. The way that President Juncker reconstructed the Commission is also very good. The capital markets union is not just Lord Hill's project but belongs to the team, including Vice-President Katainen, which gives a lot of political cover, which we can sometimes be accused of. It is not just a UK agenda; it is supported by a large part of the EU.

It is probably less ambitious than we would have hoped, but that is understandable, in that the Commission's view is that it is going to have to be taken a step at a time, because otherwise there will be considerable opposition emerging, which might scupper the whole thing before it gets off the ground. On the other hand, we cannot delay for too long. Already, we do not think that the proposal on securitisation really goes far enough. It will not revitalise the securitisation market in Europe.

Lord Butler of Brockwell: What are the deficiencies with that?

Mike Vercnocke: There are a number. One issue we have is that the Council has decided to remove the third-country provision, limiting the originating securitisations to EU-based countries, which we think is a mistake. The more practical point is that the capital requirements are still far too high and will not make securitisation particularly appealing. The amendments to the Solvency II rules also do not really go far enough, because the new asset class for long-term investments is limited to the standardised approach, rather than the advanced or internal modelling approach for insurance companies. All the big insurance companies, like Legal & General and Prudential, will not benefit from it. It is only very small insurance companies that would, which we do not really think is going to make a huge difference.

Lord Davies of Stamford: I did not quite understand that. Can you just explain the Solvency II derogation?

Mike Vercnocke: To try to get the securitisation market working, one thing is to have a new asset class for long-term finance, which will accrue a lower capital charge under Solvency II. It will mean that insurance companies are more attracted to holding securitised assets, but the way the Commission has framed it this new asset class only applies if you are a relatively unsophisticated insurance company using a standardised approach, where all your parameters are set by your regulator. All the big insurance companies use an internal model approach on Solvency II, and this new asset class is not available to them under that.

Lord Davies of Stamford: That sounds at first sight—and to me it is at first sight—like it is a big mistake to distinguish between exactly the same asset class in different insurance companies. Are you making progress in resolving that?

Mike Vercnocke: We are trying to. It has happened that way because the standardised approach basically requires much higher capital charges than the internal model approach, because it is obviously much cruder. They felt that that would help—and it will help, but it will only help small insurance companies. The ABI and other people are lobbying the Commission on that one.

Lord Davies of Stamford: Are there any case studies as to how much influence we have in regulation in the financial services area, bearing in mind that we are not part of the euro area? Do you feel we are getting the influence we ought to have in this field?

Lord McFall of Alcluith: The information on Solvency II I have had over the years is that quite a bit of progress has been made and a lot of people are happy with it. Could you put that into context?

Mike Vercnocke: It has improved. The potential delay to Solvency II now is necessary—because of the slowness of ESMA to do its work, which is understandable given their lack of resources—but also a problem. Yes, you are right. However, we have recently been informed by a few big insurance companies that the Commission has basically accepted the equivalence of US and Canadian insurance rules. Some domestic companies now feel they have a competitive advantage, because they are not applying Solvency II and therefore have lower charges in certain areas. It is a bit of a mixed picture, to be honest.

Q147 Lord Butler of Brockwell: Are there other aspects that are causing friction to the City that are being debated?

Mike Vercnocke: Perhaps I will just come back to the point about influence. Our experience is that, certainly within the Council and within the Commission, the UK's influence on financial services—I do not know about other areas—is still very strong, partially because we have the main market but generally because we have the expertise and are therefore able to provide the Commission and Council with valuable input. The area where we are weaker, I would say, is the European Parliament, where our influence is certainly somewhat diminished, but so is that of other member states. The way the Parliament went in the last election means it is much more fractured. There is no natural majority on the left or right, so it has become very much more personal. Therefore, it is quite hard to get influence in the Parliament sometimes, though we do our best.

Q148 The Chairman: Which committee do you interact with the most?

Mike Vercnocke: The Committee on Economic and Monetary Affairs.

The Chairman: As an aside, we had a committee from the European Parliament, the Committee on Constitutional Affairs, in a round-table. In the context of the United Kingdom leaving—a Brexit debate—one of the MEPs said, with the acquiescence of the others, that they could not see the merits of the United Kingdom staying in, because the United Kingdom did not provide any value added. I reminded them of Europe's financial centre being in London, but could your efforts in terms of influencing be more widely spread in the Parliament?

Mike Vercnocke: We do try, but even within the Committee on Economic and Monetary Affairs, probably only about 20 or 30 MEPs are really interested in financial services. Of those, probably a third of them do not like financial services, so it is a bit of an uphill struggle. You are right. We try; it is the same with Jeremy, who could not be here today, I am afraid. We are undertaking a whole series of meetings with MEPs, and I took Jeremy down to

Strasbourg back in October. We are reaching out to non-Brit MEPs in a big way, but it is difficult.

Lord Butler of Brockwell: I think you were going to go back to the question of whether anything is causing friction.

Mike Vercnocke: Not on a day-to-day basis, but the whole Brexit debate is seen certainly by some member states as an unwanted development or hindrance to business. I suppose there is a certain amount of friction in that. We feel that sometimes people say, “You may not be with us in two years’ time, so why should we worry about what you have to say?” I do not think there is that much. In a lot of areas the UK has a lot of supporters.

Q149 Lord Butler of Brockwell: I gather MiFID II is coming up before the Council, possibly in the next couple of weeks. Are you satisfied with the way that is going? In asking this question, I ought to declare an interest, because I am an adviser to an investment house.

Mike Vercnocke: We feel that MiFID II has come out quite well.

Lord Davies of Stamford: Is there partially a British influence?

Mike Vercnocke: There very much is, yes. The initial proposals from the Commission were not all that good. To be frank, the Corporation has really been focusing on the third-country access issue. We knew that the original proposals would be detrimental to international business in the City, basically, and we successfully lobbied through the International Regulatory Strategy Group and Rachel Lomax on that issue. We ultimately came out with quite a good solution on that, which basically says that third-country firms can operate until such time as their country is deemed to be equivalent. You are in until you are in. That was a success.

In terms of the other more granular areas, there are mixed views, depending on whether you are on the buy or sell side, but our take from the companies is that it has been quite a well-balanced piece. Obviously, it has taken a long time and we are only looking for implementation on 3 or 4 January 2017.

Lord Butler of Brockwell: I gather there has been a delay and there is now some anxiety that, if it were implemented on 3 January 2017, there would not be enough time for consultation. We are likely to be pressing for a postponement of the implementation date.

Mike Vercnocke: ESMA has as well, because there are considerable problems, particularly on the data side.

Q150 Lord Haskins: From the discussions we have had in the last couple of days, there appears to be much common ground between the UK and the five Presidents. Everybody seems pretty relaxed, on both sides, about the way that it might impact. That surprises us quite

a lot. Moving on to regulation and governance, is there a need for a co-ordinated approach where the UK is involved alongside other members through the European Parliament or wherever in establishing high standards of governance within economic and monetary union? As you have said, the British Government are very keen to make this work as well. Is this on the cards?

The other point that struck me very strongly was that somebody said there had hardly been an occasion at all when the UK had been outvoted on major regulatory proposals. That was something that frankly amazed me. The impression one gets from the British press is that we are constantly being outvoted, but never on financial proposals.

Mike Vercnocke: Not really, no. From the industry's point of view, we do not always get exactly what we want. In that sense, sometimes the vote on the final proposal is not exactly what we want, but it generally is much better than the starting point and we can live with it. The only exception is probably AIFMD, the alternative investment fund managers directive for doing hedge funds and alternative investments. Even at the end, that was not particularly good, although I think people have worked their way around it, to be honest with you.

Lord Davies of Stamford: Do you mean the hedge funds financing the Brexit movement?

Mike Vercnocke: Exactly, yes. The only area we lost out would be on the bankers' bonuses.

The Chairman: I was just going to say that. What is your view about that?

Mike Vercnocke: In actual fact, most of the UK MEPs voted in favour of it, and I imagine it was probably one of the most popular things for the populace in the UK anyway. You are right; in general terms, I cannot really think of any clear examples of where we have lost everything, as it were. All the countries find that they do not quite like something, because that is the way it works; it is always on a compromise.

Lord McFall of Alcluith: Have you lost out on bankers' bonuses, in the sense that there is still plenty of latitude for interpretation?

Mike Vercnocke: There was, although the EBA has come out with some stricter rules. We reckon the bankers' bonuses had a very limited impact, but it did potentially have a negative impact on some of the global heads of business lines in London. These people were running the global business, basically, or all the business outside the US, for example. The issue there was that, if they could no longer be paid competitively and moved from London, the supervisor might also say, "Actually, the team they run should also move, because they should be in the same place". To be honest, we have not seen much of that. The only downside, and we do have some data on this, is that the fixed costs of doing business in London have gone up compared with those in New York.

The Chairman: From where you sit, and recalling where that conversation started, would you agree that what we got at the end was a lot more in line with Anglo-Saxon concerns than continental southern European concerns?

Mike Vercnocke: Certainly the capital requirements directive and regulation in general came out better.

The Chairman: I was talking about the bankers' bonuses.

Mike Vercnocke: It was more of a populist proposal. Even Michel Barnier did not propose it and had his doubts about it. It just came out from the European Parliament, particularly from the left, but it had quite a lot of support in the European Parliament, across the spectrum in fact.

Q151 Lord Haskins: Going back to the regulation of the euro, it has been raised with us that a lot of attention is given to countries running big deficits and not very much attention is given to countries running big surpluses.

Mike Vercnocke: Such as Germany.

Lord Haskins: On the face of it, this should be nothing to do with the UK but, on the other hand, this is not an issue that just relates to the euro. It is a single market issue too. Do you expect the British Government to take a strong position on something like this?

Mike Vercnocke: Certainly the alert mechanism report, which the Commission puts together, identified Germany as running too high a current account surplus and that is part of the problem facing the eurozone. Yes, it comes back to this point that, although we have these mechanisms in place and the European semester, I am not sure that is going to be that well enforced, particularly in the present climate. The general feeling is that there is not really much solidarity, even across the eurozone.

Lord Haskins: The impression I have from you is that, as many people have told us, somehow the euro will muddle through for the next few years.

Mike Vercnocke: Absolutely, yes. I should point out that I have a slight history here, because I was seconded from the Bank of England to the European Commission in 1995 and worked on the introduction of the euro for three years, so I am guilty.

Q152 The Chairman: It is all your fault. Before we bring in governance, what can we learn from the US—witnesses have mentioned the US—and other mature federations in terms of financial and budgetary integration policies? From your perspective, what would a fully integrated financial union look like, in terms of reducing the need for a fiscal union?

Mike Vercnocke: The fundamental difference between most of the European Union and the US, of course, is the social model. One of the reasons the US has such a developed capital

market is because of private pension funds and private provision of wealth. Therefore, unless you were to see a wholesale change in how most of continental Europe structures its social structure, it is hard to see that sort of development of capital markets. On the other hand, if you are looking at the demographic problems in Europe, in terms of the ageing population and the difficulty for Governments in finding funding for state pensions, even the Commission's view is that there ultimately has to be a move towards private pension provision in Europe. If that were to happen, we would potentially be much closer to a US-style model but, without that, I do not think we would ever get there, because you do not have the funds going into it.

Lord Davies of Stamford: Things are moving in that direction quite significantly.

Mike Vercnocke: They are, but quite slowly and in some countries more than others. Holland obviously has a big pension fund. We do. In France, it was illegal to create a private pension fund until about 10 years ago and the only private pension fund was for civil servants.

Lord Davies of Stamford: There are now quite a number of supplementary funds.

Q153 The Chairman: If we had enhanced financial integration, through all the different areas that we have discussed, would that reduce the need for a fiscal union at that overarching transfer level?

Mike Vercnocke: A lot of these things, fiscal union and political union, are bandied around in Brussels, but no one is ever quite sure what they really mean. In terms of fiscal union, I do not think anyone is really looking at a complete single budget and basically one government, in effect. You are possibly looking at the means for some fiscal transfers. It is just to what degree you do those. Obviously the deposit protection scheme is a start in that direction. It is very limited obviously, but that would be mutualisation. The idea in the Five Presidents' Report, as I said earlier, of creating a eurozone treasury would be another move. You are right that how far along that line you go in terms of fiscal union depends on what other things you do. If in fact you solve recovery and resolution in the financial sector, and therefore you cut the link between the sovereign and the financial sector, some of the fiscal issues probably go away. However, you still come back to the problem of some countries running large current account surpluses and others running permanent current account deficits, which obviously is not sustainable.

Lord Haskins: One distinguished witness told us that his idea of fiscal union was to increase the size of the EU budget from 1% to 2%.

Mike Vercnocke: Radical stuff. Of course, the Commission's view is one option is to reduce the contributions by member states and have some sort of direct taxation going to the Commission.

Q154 Lord Shutt of Greetland: Moving to the effective governance of the eurozone, do you think there is any need for further institutional strengthening or reform?

Mike Vercnocke: From the point of view of making the eurozone work efficiently, yes, there is.

Lord Shutt of Greetland: What would it be then?

Mike Vercnocke: It comes back to the fiscal issue a little. How should I put it? There has to be some mechanism for ensuring a more consistent economic programme in eurozone member states—i.e. they ultimately all have to be far more convergent in their economic policies. You need some mechanism to enforce that. I am not saying it is a good idea but, if you really want the eurozone to work, you cannot have some countries increasing their debt massively and others not. You need some mechanism to ensure some discipline in how they set their budgets, but then it comes to political union. How can you do that and still have democratic oversight? If the central body is setting the budget, what is the national government doing?

Lord Shutt of Greetland: If we had that, would it be a different outfit in which the UK is not involved?

Mike Vercnocke: I would imagine so, unless we are in the euro. The other area where we may see developments in the ECB is probably on the capital markets side, where the ECB has at various meetings said ultimately it sees a role for itself as the supervisor in other sectors, not just banking.

Lord Shutt of Greetland: Is there anything else on the democratic accountability front?

Mike Vercnocke: It is a very difficult area. The most democratically accountable bit of the European institutions is the European Parliament, and yet no one in the populace, not just in the UK but in most countries, takes it very seriously, yet it is the one area where you have direct elections. It is quite difficult. The press in the UK is not entirely fair when it says that it is very undemocratic, because clearly the Commissioners were appointed by the democratically elected Governments of the member states; the Council is a democratically elected Government. The Commission is less so, obviously, and I suppose that is the area where there are issues, because obviously the Commission is both legislator and Executive at the same time.

Q155 Earl of Lindsay: If you look at the whole agenda that is currently up and running, and is going to run for the best part of 10 years, is there good, effective communication between the City of London and the UK Government, in terms of identifying optimum policy positions, negotiating positions and so forth? Would you also share with us perhaps any issues

where there are differences of opinion between the City of London's preferred position and the UK Government's position?

Mike Vercnocke: As you would imagine, we have quite a close relationship. Certainly at a political level, my chairman, Mark Boleat, sees this on quite a regular basis. At a working level, we have a lot of interactions with the Treasury and fewer with the Foreign Office, although we do sometimes because of our foreign travel. Operationally with UKRep we have very regular contact just generally to share information. It is not that we are exactly the same. You are right; we do not always entirely agree. In broad terms, I would say that the City of London is very much in line with most policies of the UK Government. There are areas where we disagree. Immigration is one. The City of London is very much a supporter of immigration. For obvious personal reasons, the City needs immigration to function.

Earl of Lindsay: In terms of the EMU and the Five Presidents' Report, are there any sharp differences of opinion between the City and the Government?

Mike Vercnocke: Not particularly. One where we did have a difference of opinion and we lost was on the capital requirements directive, where the firms in the City were very much in favour of a maximum harmonisation approach, so that the rules applied were the maximum and you could not do anything in addition, whereas the Government wanted the Bank of England to have more flexibility and be able to apply tougher rules than those in the directive. We lost that battle, but it is usually only on the margin; it is not usually about the big thing. For example on MiFID, we did not have a disagreement, but we certainly had quite lengthy discussions with the Treasury on the third-country access issue.

The Chairman: If you take, for example, the inclusion of these additional criteria in the alert mechanism scorecard, are you comfortable with that?

Mike Vercnocke: Yes, I think so.

The Chairman: The City was comfortable with that.

Mike Vercnocke: Yes, it was. To be frank, I do not think it was a very big issue. I can always check on that point.

Q156 Lord Davies of Stamford: I would like to come back on capital markets union, which I am sure you spend a lot of your time on. There is obviously tremendous fragmentation in the single market at present. The French and Germans are better at private placements and venture capital than we are, and various things in that direction. There is obviously, in theory, a lot of good things to go for, both the microeconomic and macroeconomic, with benefits to the financial services industry, cost of capital issues and stabilisation issues—big things potentially. It could be very important. How much of the problem is really a traditional

institutional problem and how much of it is really regulatory or legislative obstacles to integration? If it is the former, it is a question of harmonising or integrating attitudes or behaviour, which may be a difficult agenda. I do not know how you achieve it; perhaps you could tell us. If it is the latter, we need to know very precisely what the legislative and regulatory impedimenta are, so that we can encourage Commissioner Hill to focus in on them and get a directive very soon and remove any contrary directives. How are you addressing the habits-of-mind issue and traditional ways of doing things in different financial markets? Secondly, what are the key obstacles in terms of legislation and regulation that need to be removed?

Mike Vercnocke: You are absolutely right that one of the biggest obstacles to the development of capital markets is a cultural one. In some member states, Italy for example, the capital market is really just government debt and some company debt. There is very little else. In many of the newer member states, like Romania or Bulgaria, they have a capital market, but it was simply set up to fund the Government when they privatised what had been state-owned companies. There is no actual capital-raising on them for new companies. That is partially a cultural thing—people just do not think of going to the capital markets.

In some countries it is more structural. In Germany, there is considerable opposition to the capital markets union, apart from the Bundesbank, which is very much in favour, but everybody else seems to be pretty much against it. That really stems from their three-pillar banking system. The savings banks are very concerned. At the moment, they monopolise a large part of the financing of small companies, at any rate, and if those companies entered the capital market they would lose their business potentially. We are not sure if that is a real risk. There is a lot of opposition.

Lord Davies of Stamford: Are there any legal obstacles there at the present time to be removed or not?

Mike Vercnocke: In actual fact, Lord Hill is absolutely right in saying that he is trying to look at a bottom-up approach and what minor things need changing, rather than coming with a grandiose, huge European grand strategy of lots of directives, because there are probably not that many regulatory barriers.

Lord Davies of Stamford: That is my feeling. I cannot get anybody to quote me any specifically.

Mike Vercnocke: We have some, which we have known for years, because Alberto Giovannini in the famous Giovannini Group 10 years ago looked at barriers in the financial markets, particularly in the material settlement area. Those barriers are known and the market

ones have generally been dealt with. Most of them are national laws; they are national protectionist rules.

Lord Davies of Stamford: Those can and, we hope, will be dealt with.

Mike Vercnocke: We are slightly concerned that, when we have talked to quite senior people in the Commission on this point, they say their approach to this, which we approve of in a sense, is not to regulate and come up with new rules but to point out to member state governments where they have national barriers to the capital markets. They say those countries will then remove those barriers. We are a little sceptical about that.

Lord Davies of Stamford: A lot of Jonathan Hill's activity is going to be exhortation rather than actual law-making.

Mike Vercnocke: Absolutely, yes. There will not necessarily have to be new regulatory directives but some amendments to current ones.

Lord Davies of Stamford: Have you, in the City of London Corporation, got a list or a couple of pages of what needs to be done, in your view?

Mike Vercnocke: Yes, we do have papers.

Lord Davies of Stamford: I would love to see some, and I am sure colleagues would too.

Mike Vercnocke: Yes. You are right that, in a sense, one barrier to some of this work is of course taxation and the different treatment of equity in different countries, and generally the disadvantage of equity over debt, in terms of fiscal treatment in most countries.

Lord Davies of Stamford: That is universal. Every jurisdiction in the world that I know of has that.

Mike Vercnocke: Exactly, so there are areas that may need some amendments, but there are not as many barriers as you think. It also comes back to the point I made about pensions: in some countries there is no natural system or effective mechanism for making good choices for investing savings, basically. You either put it with your local bank at 0.5% if you are lucky or you put it under the mattress. You do not go out and buy equity; it is not a natural thing to do. Indeed, in some countries, entrepreneurs who open a little company do not actually want to sell the company. They want to keep the company as it is and pass it on to their children. That is probably a bigger barrier than some of the other things.

The Chairman: If you have any publicly available documentation, we would be delighted to receive it. I think that brings our session to a conclusion.

Q157 Lord Haskins: May I just ask a question outside of this debate? Is the City of London going to take a position on the Brexit debate?

Mike Vercnocke: Our chairman was in the press last night, in the *Evening Standard*.

Lord Davies of Stamford: We have not seen that.

Mike Vercnocke: Frankly, the City of London Corporation does not have an official position on Brexit. We are trying to facilitate a debate, so we have been holding various events. It is clear that certainly the vast majority of companies operating in the City are in favour of staying in the European Union, purely for their own gains. We reflect that to a degree, but we fully support the Government's approach to renegotiate, and I guess we will be waiting to see what the package is.

Lord McFall of Alcluith: I was at a breakfast with Mark Boleat just a few weeks ago, and there was the intention of coming out and articulating your position very strongly, engaging business in it as well.

Mike Vercnocke: We are certainly encouraging business. From both sides, business needs to speak up. There is no doubt about it.

Lord McFall of Alcluith: That was one of the comments that I was discussing with him. I was giving my views on the Scottish referendum. Business largely flew under the radar, other than a few exceptions, until a few weeks beforehand. That led to a climate of fear and negativity.

Mike Vercnocke: The issue for some of the big companies in London is that, whilst they would find the UK leaving the European Union a nuisance, it would not destroy them, because they would just restructure. Therefore, in a sense, they probably are a bit more concerned about coming out. Certainly the companies that have big retail bases are quite concerned about being pigeon-holed as in or out, for obvious reasons.

Lord Davies of Stamford: You exist to be the focus for City opinion. You do owe it to the City and the country, if I may say so, to make clear what the consensus is.

Mike Vercnocke: Certainly once agreement has been reached, we will do that.

The Chairman: In concluding, are there any demands from your perspective on the City that we have not heard?

Mike Vercnocke: No, not really. You have covered everything.

The Chairman: We covered the ground fairly comprehensively. Thank you very much indeed, Mr Vercnocke. This brings to an end the public part of the meeting. We are very grateful to you for having come and given up your time so generously.

Mike Vercnocke: Thank you very much.