

TUESDAY 10 NOVEMBER 2009

Present

Cohen of Pimlico, B (Chairman)
Haskins, L
Hooper, B
Jordan, L
Moser, L
Northover, B
Renton of Mount Harry, L
Trimble, L
Woolmer of Leeds, L

Witnesses: **Lord Myners**, a Member of the House, Financial Services Secretary, and **Mr Stephen Pickford**, HM Treasury, examined.

Q1 Chairman: Minister, thank you very much for coming to see us again. We shall of course all see you again tonight at the debate which is in my name, to which I much look forward. You have been here before and you know that we record the meeting and we offer you a transcript to look at afterwards. There are various declarations of interest scattered about but the people who really have an interest in the AIFM Directive, which comes second in our list of questions, will not in fact be present. Baroness Hooper will not be present for the second half and Lord Browne of Madingley has felt it necessary to disqualify himself due to where he runs a couple of hedge funds in America. Of those of us who are here, the only material indirect interest is mine as a Director of the London Stock Exchange. We have a list of questions slightly re-ordered but it is the ones you have seen. Would you like to make a general statement, Minister, or would you like us to start?

Lord Myners: Could I just say a few words at the beginning, Chairman, firstly to introduce Mr Stephen Pickford, who is a senior official in the Treasury. Mr Pickford is here in particular to rescue me on complex technical issues relating to EU Financial Regulation and

Supervision, and he will stay for this part of the session and then leave me on my own when it comes to the AIFM. Let me say very briefly in relation to EU financial regulation and supervision that the UK Government strongly supports the move to improve the quality and consistency of supervision, to ensure more effective rule-making and enforcement and better identify risks in the financial system. We therefore support the ESAs' rule-making role, their role in enforcing rules, their role in peer review to ensure high standards and their ability to settle disagreements. Such moves should improve the quality and consistency of supervision in the EU. The Heads of Government agreed at the June European Council that the ESAs should not impinge on Member States' fiscal responsibilities and day-to-day supervision should remain national. This means that there can be no direct powers over firms and that the ESAs can only directly supervise credit rating agencies, given that a failure of a CRA is unlikely to result in a fiscal obligation for Member States. We stick to the position that was agreed by the Heads of Government at the June European Council. There are a number of complex legal matters which are still outstanding, some of which I imagine we will cover later on. But a strong statement of support for the direction of travel contemplated by the EU.

Q2 Chairman: Thank you very much, Minister. I would like to ask about the European Systemic Risk Board. It is an entirely new body conceived with no legal basis and binding powers, which will exercise its influence via its reputation, as far as we can see. When necessary it may issue specific recommendations to address any identified risks. What does the Government think about this and how do they think it will work?

Lord Myners: We believe that the proposed Systemic Risk Board will be a valuable addition to understanding the development of systemic risk, the exchange of information and debate and discussion around likely mitigating actions. We think that the ESRB is best placed to identify risks as they emerge in the financial system and we expect their warnings to carry weight. The ESRB will also, where necessary, give non-binding recommendations as how to

best mitigate the risks. The ESRB sits as part of a complex architecture which is now being developed in the light of our knowledge and the consequence of the financial crisis. At a global level we are going to see a much more important role for the new Financial Stability Board which has emerged out of the Financial Stability Forum, which will work with the IMF in developing global early warnings of the build-up of systemic risk, perhaps the excess use of leverage or increasingly illiquid funding. And beneath the European Systemic Risk Board, although not in a constitutional sense but at a national level, we are going to see an enhanced role for the FSA in financial stability and a new statutory responsibility which will be placed on the FSA as a consequence of legislation which we will be announcing immediately after the Queen's Speech; and of course the new Council for Financial Stability, which will succeed the Tripartite framework and give much more formality to the work that joins together the FSA, the Bank of England and the Treasury, and, importantly, more transparency to the process than was the case with the Tripartite arrangement.

Q3 Baroness Northover: Following on from that my question is will this body be effective in strengthening the macro-prudential supervision in Europe? And if you can project forward because, obviously, who knows, what in its current structure do you think it might help and where do you think it has weaknesses?

Lord Myners: I think it does have the potential to play a valuable role. By bringing together representatives of the Member States of the EU and developing a coherent European-wide view it has considerable potential. I think that there are weaknesses in the structure which we are seeking to address. It is to ensure that it is not a body that is dominated by the ECB, who quite rightly will provide the Secretariat for the ESRB, but should be seen as a servant of the ESRB in that respect rather than its leader. Of course, some of the consequences of it being composed of central bankers will mean that those responsible for financial regulation in some individual Member States will not have an equal voice at the table; so we need to ensure

through various sub-committees and technical advisory groups that organisations such as the FSA have an appropriate voice.

Q4 Baroness Northover: Leading on from that and your comment about central banks, there has been some criticism that the current proposals give too much responsibility to central banks considering the limited experience of some of them in macro-prudential supervision. Could you go a little further on that?

Lord Myners: I think that will always be the case with any body or institution set up under the sponsorship of the EU, that there will be some Member States who have a much more intensive interest in the subject area and much more knowledge than others, but a balance has to be struck between inclusivity and, on the other hand, making sure that the most knowledgeable voices are the ones which have the greatest influence. That is why we think that it is particularly important that the Bank of England and the FSA play a full and important role in supporting the ESRB.

Q5 Lord Renton of Mount Harry: Lord Myners, it is very good to see you again. My question follows on very much from Lady Northover's. You have probably read or had pointed out to you the article by Willem Buiter in the Financial Times of 28 October: "It is astonishing to have a proposal for a European Systemic Risk Board that does not find a place in the key decision-making bodies for the fiscal authorities... a proper tripartite representation, with equal voting rights for central banks, fiscal authorities and regulators/supervisors, has much to recommend it." Do I take it that you do not agree with Mr Buiter's view?

Lord Myners: Professor Buiter very rarely understates his case. I am an avid reader of his FT Maverecon website on which I have often been very impressed by the power of his argument. On this particular point I think that Willem misses that the ESRB is an early

warning and advisory body rather than a decision-making body, and that the ESRB will not have the ability to take decisions which have a fiscal consequence. Again, Lord Renton, we come back to the need to strike a balance between representation and having a manageable body. I have attended ECOFIN meetings and I can remember when I first walked into the ECOFIN meeting in Prague – it must have been back in May – I just thought how can a group with this many people make decisions? It does make decisions but I think that it pushes the absolute boundaries of being a manageable group, so I think that ESRB – and this comes very much out of the excellent work done by Jacques de Larosière – is a manageable number; but to add fiscal authorities in addition to central banks and regulators in an advisory capacity I think would be to strain that test of practicability.

Q6 Lord Renton of Mount Harry: Is there not a possibility that with so many committees, each getting worried and reporting to each other and the next one having rather more power than the first one, if some bank is really getting into trouble by the time all these committees have agreed they are going to be in real trouble. Is there not a danger of it becoming a very top heavy process?

Lord Myners: I think everybody wants to have an involvement in this process, hence the IMF regional groupings such as the EU and national authorities. I think any risk of it being top heavy pales into insignificance compared with the consequence of failure to identify system risk, as we have seen ourselves in respect of the actions we have had to take in respect of a number of UK banking institutions. So I do not think that the risks and the reward here are symmetrical around a central and correct point; that is to say, if there is a danger it is the danger of not doing enough rather than a danger of having too many people looking at the build-up of systemic risk, if that were to happen.

Q7 Lord Renton of Mount Harry: My question was about the amount of delay that was likely to happen if it was a month before the next committee met and then another month before the one on top of that. But the delay could be at a crucial time when action was needed.

Lord Myners: I think the answer there, Lord Renton, will lie in the Secretariat and the support and their ability to take swift action and produce swift recommendations as and when required. Our experience in dealing with a crisis – and of course this group is designed to identify a crisis early on but sometimes they come at you very quickly – certainly does not sit neatly with having quarterly meetings planned several years ahead; so a steering group will have to establish a framework which will allow speedy address of an emerging issue.

Q8 Lord Trimble: Your last comment rather disturbed me because I thought that if a crisis came up suddenly you would react to it – you meaning Her Majesty’s Government – and would not sit around waiting to have the matter discussed by the ESRB, or whatever you call it.

Lord Myners: No, and if I gave that impression, Lord Trimble, then I apologise for being misleading. The role of the ESRB is to identify the development of adverse weather patterns, to prepare national regulators and individual institutions for the emergence of pressures in the system. The ESRB would not, in my view, have a role to play in the resolution of the problems affecting a particular institution, and if I gave the impression that we would await a meeting I apologise for not being precise in my use of language.

Q9 Lord Woolmer of Leeds: But is it not the intention of certain proposals that the board would do much more than identify weather bands; is it not the intention that they should be able to make recommendations to Member States as to actions that might be required and that is really quite a different matter. My second point is, in terms of international discussions –

because systemic risk is a global matter and not one confined to Europe – would the Systemic Risk Board and its Secretariat be the basis on which Europe would have discussions, say, with the United States on systemic risk, and if that is the case where does that leave the United Kingdom Government?

Lord Myners: I am going to ask my colleague to answer the second part of the question, fresh as he is from the G20 Finance Ministers' meeting in St. Andrew's last week. I would say, Lord Woolmer, in answer to your first point that the ESRB will not have a role in respect of addressing a risk specific and particular to an individual institution. It will not have the information or the means to address the failing institution. Plans for recovery and resolution must rest with the national financial regulators and, if there is a tax issue, with national treasuries. The ESRB's role would be when they see – if I can stay with my analogy of weather – the build-up of pressure, if they see threatening cloud patterns advancing to advise that that is the case. I imagine that that would be around a situation in which banks were, for instance, becoming more leveraged – and with the benefit of hindsight it is very clear that that was happening throughout the last decade, banks were increasing their return on equity even though their return on assets was declining, and they were achieving this by putting more and more debt on to a slimmer capital base, and I would expect the ESRB to be identifying that sort of pattern, as I would a pattern where increasing reliance was being made on wholesale deposits rather than retail deposits. I would expect them to have the regard to the valuation of important collateral, moving outside traditional valuation bands. There are ways of looking at the valuation of commercial real estate or residential property where the ESRB would perhaps begin to see some warning signs that there was risk building up in the system. That is where the ESRB I think would be at its most potent, looking at those risks across Europe and bearing in mind that our major financial institutions are increasingly pan-European in their scope and therefore not vulnerable to national economic pressures alone. Then importantly, through its

ability to give warnings, to draw attention to risk and to identify, if it thought appropriate, mitigating action that it believes should be taken, but it would not have the power to take that. Perhaps Stephen Pickford would like to answer the question about whether we are giving all our powers up as a country to the EU.

Mr Pickford: As Lord Myners said earlier, I think it is clear that the ESRB will be an important part, but only a part, of the global architecture to try and identify risks. The international approach has developed very much over the last couple of years, in particular with the setting up of the Financial Stability Board and the strengthening of its capabilities, and also its exercise jointly with the IMF to give early warnings of systemic risks. The ESRB, given its role in terms of looking across the European issues, will obviously want to coordinate with those other international institutions. But I think it is clear from the meetings that the G20, for example, is having or indeed the IMFC twice a year at the IMF meetings, that the UK will certainly have its own voice and its own role in those discussions since we are a full member of both of those bodies.

Q10 Lord Moser: I have got used, in these months of discussing this, to use the word “risk” without ever asking what we mean by it and now somebody is setting up a board to deal with this. I worry about it because there are so many ways of approaching the very concept of risk and when we were in Brussels last week some people wanted it to be something very, very simple that the whole world can understand and some people wanted it to be more sophisticated. Without going into that in detail, when you use the word “risk” do you have in mind that all of these new institutions and the new structure will be saying the same thing when they use the word “risk” and will be defining it in a comparable way? Or will different institutions have their own way of looking at it – different banks, different organisations, et cetera?

Lord Myners: I think it is important that a common language is developed and there is little risk of misunderstanding of what people mean by “risk”. Last week I went to the National Theatre to see David Hare’s play, *The Power of Yes*, in which essentially he mocks the view that risk could be capable of being expressed and predicted mathematically, and I think we did fall into the trap of believing that complex algorithms and equations were capable not only of capturing risk but of predicting risk, and if we need to come back to a way of expressing risk, particularly when it comes to systemic risk, which is expressed in words in addition to numbers. So I think it would be very important for all these bodies – the FSB, the ESRB, the CFS - to make sure that they are using common language about risk and what they mean by risk and where they see that risk developing. I have captured, I think, some of those areas in answer to an earlier question where I believe that those bodies would be looking at risk systemically and it is possible then to take that down to an individual corporation. From my base previously as a career banker where I learnt almost all I know about banking at your feet, Claus – or at least we both tried to learn at the same time – I think it would be disappointing if the ESRB was drawn towards an overly mathematical view of risk.

Q11 Lord Renton of Mount Harry: Yes. I was not going to refer to our time together in a certain bank, but you certainly learnt – I do not think I did! It is still a bit worrying, is it not, because if this important new institution is going to judge that somebody or other is doing something which is beyond acceptable risk I find it difficult to see how that could be done unless it is pretty precise and not just, “You are being naughty, you people.” It cannot just be that; there must be criteria. I do not want to press this too far – we have too much else to talk about.

Lord Myners: I think the ESRB will not be focusing specifically on individual institutions. That is not to say that I could not contemplate a situation in which the ESRB would become very concerned about an individual country’s banks or conceivably a small group of banks

within one country or a small group of banks of a certain type across a limited number of countries. In those situations I envisage that the ESRB would, through representations – probably initially private to individual national regulators - draw attention to what they saw as a build-up of risk pressure. They always have the option as well of making a public statement if they wanted to, but I believe there are no circumstances being contemplated in which the ESRB would make public comments about an individual institution.

Q12 Baroness Hooper: The ESRB will nevertheless, presumably, have to work to some sort of defined systemic risk and am I right in thinking that the European Central Bank, which is providing the Secretariat to the ESRB, is even now working on that definition?

Lord Myners: I would be very surprised if it was not but I cannot say categorically that it is. Mr Pickford might know.

Mr Pickford: I do not know categorically either, but I do know, for example, that the BIS has done a lot of work on how to define systemic risk. The IMF and the FSB in conducting their early warning systems are attempting to put together metrics as to how to define when you have a build-up of risk. These are not easy questions at all, but I am sure that the ECB will be doing similar work and my own view is that it is good to have a number of these organisations looking at those issues because I suspect that one on its own would not come up with the right answer. I think you may have a better chance if you have multiplicity of advice.

Lord Myners: The Bank of England clearly is also now increasingly focused on this because of the enhanced responsibilities that the 2009 Banking Act gave to the Bank in respect of financial stability, and the constitutional role now given to the Financial Stability Council within the Bank of England to have regard to financial stability. So they will be working on this as well. If I have a concern here, quite frankly, Lady Hooper, it may well be that we are spending so much time debating and discussing the economics and philosophy of financial stability as opposed to getting on with doing the real work of addressing the gathering and

analysis of information that there is a risk, as always, that as the crisis slips further away from our immediate memories – although it has not slipped at all from my immediate memory – the enthusiasm for change diminishes.

Q13 Lord Haskins: Pursuing his issue nevertheless, I am intrigued by your meteorological references because I suspect you may have read the *Financial Times* this morning on meteorological references, Gillian Tett, who says that there are 73 meteorological people who get together in Europe to discuss future trends, and she gives the example of 72 say Canary Wharf is not likely to be swamped by a flood in the next 12 months or ten days and one says it will be and Canary Wharf is swamped and then the other 72 have got themselves into a position. The difficulty I have is that when it comes to it, it seems impossible that this Systemic Risk Board would not have referred to an Icelandic crisis, for example, or an Irish banks' crisis, rather than a macro-crisis with specific problems going on with the Icelandic banks and the Irish banks, on which this group, Systemic Risk Group, would presumably identify and concentrate. My worry is that this board could become over risk averse and that actually you could be putting up all sorts of danger signals and warning signals which could stifle the system. How do you stop that happening?

Lord Myners: I have not read Gillian Tett in the *FT* today.

Q14 Lord Haskins: You need to; I commend her writing.

Lord Myners: She has consistently shown an extraordinarily good understanding of what has been happening in the world's money and banking markets. I do recognise precisely the point you are making. I have the same feeling when I see those signs inside the door of government buildings warning of the security level and ask myself where is the incentive for anybody ever to lower the security level and why would they ever do that and run the risk that something happens. So there is a natural inclination to keep the level of declared risk high. The wise

people that tend to head central banks hopefully will not fall into that trap. You mentioned Iceland and Ireland. The Irish problem was actually a classic case of a build-up of risk in the Irish banking system which should in theory have been caught by the sorts of tests I am describing. Irish banks were increasingly reliant on inter-bank funding rather than domestic deposits; loan-to-value ratios were exploring territory never previously inhabited, as were loan-to-income ratios and so I think in some ways that was a rather classic model. Iceland was far more complex – how a country that ends up with a banking system ten times its own GDP is extraordinary, but one would have hoped that the Financial Stability Board or the ESRB would have spotted something like that happening.

Chairman: Lord Jordan, would you like to ask your question on this one and then we are going to move to supervisory authorities.

Q15 Lord Jordan: Buiter, to whom you referred earlier, described the design of the board as a “shambles”. Do you think that he was overstating his case there? He also thought that it was ludicrously lopsided in favour of central banks. You have commented on the size of the body and you diplomatically downplayed the difficulties that it is likely to encounter but was the reference to the dominance of the central banks referring to the fact that generally this is the same group of people who allowed the last crisis to creep up and overtake them; and why should they see things, with the interests that they have individually, any differently now?

Lord Myners: I hope in response to the final part of your question that we are informed by our experiences, individually and collectively, to the extent that central banks played a part in the conditions which led to the financial crisis, and I believe they did; but so, goodness me, did boards of directors, shareholders, regulators and treasuries. Then one hopes that they are better informed as a result of this experience and will not repeat the mistakes of the past. The creation of this new architecture, for which there was considerable enthusiasm when Larosière first reported – although I think there are some that are now less driven by a wish to see an

early implementation, perhaps at the behest of lobbying from the banking industry – nevertheless, I think the fact that the ESRB and the ESAs are going to be created is an indication of our wish to ensure that we do not see a repeat of the circumstances of the past. I repeat, Lord Jordon, that in response to the size and complexity of the ESRB that it needs to be inclusive. The EU now embraces 27 Member States and it is only right and proper that they are all represented. So the answer must lie in how the ESRB decides its internal processes to ensure that those matters which require either deeply technical and complex analysis or swift analysis are handled by a group that is appropriate to that, whilst those which are much more of a political strategic nature are successfully taken through the formal ESRB board. Stephen, is there anything else that you would add to that?

Mr Pickford: No, thank you.

Q16 Lord Woolmer of Leeds: Can I explore the powers or otherwise of the European supervisory authorities? They are being instituted under Article 95 of the EC Treaty, which is appropriate for a body “contributing to the implementation of a process of harmonisation”. I take it that the supervisory authorities will not have the power to make rules or to enforce rules. The language that is being used is to “issue guidelines” and to impose on the relevant authorities an obligation to make every effort to comply with the guidelines. Do you think that the legal base on which these authorities are being established is actually going to give them binding powers and eventually the power to make rules? Is there a distinction in between making rules and issuing guidelines and what does the legal base actually provide for?

Lord Myners: We think that Article 95 of the EC Treaty is the right legal basis – that refers to the establishment of a body contributing to the implementation of a process of harmonisation. The work of the three new ESAs is aimed at harmonising regulation and supervisory practices across the EU; so I think that Article 95 is the appropriate legal basis.

Under the Treaty the Commission is able to delegate binding powers to authorities provided that, (1) the Commission has these powers in the first place; and (2) that decision-making powers that are delegated do not involve wide discretion. There are a number of questions still to be answered about the legality of the proposals. These are very complex issues. There is considerable case law on how EU agencies should operate, particularly the *Meroni* principle. The Government is working with other Member States and, importantly, with the Council Legal Services to ensure that the three ESAs are legally sound and can withstand legal challenge.

Q17 Baroness Northover: Following on about the powers of these authorities, you actually said in your introductory remarks – or you made some comments – that perhaps indicated that it is not quite as indicated or is being picked up by certain critics or the powers of these authorities. But the proposal would provide the authorities with the power to apply a decision to the financial institution affected if, in the case of the UK, the FSA did not agree to implement what they were instructed to do, as I understand it. So the question is: does this provide the authorities with the power to overrule national supervisory authorities? And bearing in mind also the decision would only be adopted by Qualified Majority Voting in the Authority, so therefore the country in question could not, as it were, veto it. Could you comment on where you think things have got to because it sounds as if this is a matter which is evolving?

Lord Myners: Yes. As drafted, the ESAs will be able to take decisions that are directly applicable to national competent authorities and to individual firms in some areas. We are not content with that drafting. The Government has from the very start been clear that there can be no powers for EU bodies over individual financial institutions. This directly contravenes the concept that day-to-day supervision should remain national. It was agreed by the Heads of Government at the June European Council meeting and repeated at the October European

Council meeting and repeated at the October ECOFIN meeting, and is a position which must be adhered to. The Commission, as is its wont, has gone further than this agreement in the proposals that it has tabled. But in the absence of a workable burden-sharing arrangement – and I have not seen a workable burden-sharing arrangement – I see no grounds for EU powers over individual firms, particularly given that the ultimate fiscal cost of bailing out such institutions will fall on the national taxpayer.

Q18 Baroness Northover: So looking at it the other way and playing devil's advocate, as it were, what is the power of this body? What are the powers of these bodies if they cannot in the end finally implement it, if there is resistance from the national supervisory authority?

Lord Myners: The ESAs have very significant responsibilities in terms of developing a common rule book, reviewing adherence to that rule book, instituting good and proper peer review processes and challenging areas where they identify shortcomings; and they can pursue that route until the point that it has fiscal consequences. But where it has fiscal consequences that responsibility must rest with the national fiscal authorities whose taxpayers will bear the burden and whose taxpayers therefore must be in a position to form a view as to whether their elected government has taken the right action. Stephen, would you like to add to that?

Mr Pickford: I think that covers it.

Q19 Baroness Hooper: Following on from that, anxiety has been expressed about the proposal which outlines a process of appeal for Member States if they do consider a decision to impinge upon their fiscal authority. Given that the decision will remain in place until overturned by the Council, and that the appeal process may take as long as three months, as I understand it, are you satisfied that this process will adequately prevent the authorities impinging upon the UK's fiscal authority?

Lord Myners: An ESA decision is suspended where a Member State invokes the fiscal safeguard clause. If the ESA subsequently maintains its decision the Member State will then need a QMV in Council to enable it to continue to opt out of the decision. If it fails to get this support the Member State would then have to implement the ESA decision. As I have said, at the June Council and on several occasions since then, the European Council and ECOFIN together have made it clear that any decisions made by the new bodies should not impinge in any way on the fiscal responsibilities of Member States. The provision in the legislation makes it clear that ESAs cannot take decisions that have fiscal impact. Furthermore, Member States can challenge a decision with respect to the fiscal implications. We need to ensure that this mechanism is workable in practice. I am not convinced that it currently is; however, I stress that this mechanism should never need to be used as it should always be the case that ESAs do not make decisions that could have a fiscal impact on a Member State. So we are talking here about how we perfect something which should never in practice occur, and we will hold to the line that was agreed by the Heads of Government in June, which I think really sets this issue to one side as being of a theoretical nature.

Q20 Baroness Hooper: So watch this space?

Lord Myners: Yes.

Q21 Lord Trimble: But you have not yet succeeded in compelling the Commission to agree to the line that you say you have been holding in ECOFIN?

Lord Myners: I am going to invite Mr Pickford, who is a great expert on these things, to add a correct interpretation here, but I have to say that as somebody who was until recently very much a layman when it came to the world of politics and government I have always believed that the European Council, comprised of elected heads of government, must always set the tone and that the Commission in that respect will have to produce recommendations which

accord with the Council's decisions rather than the other way around. Stephen, you will explain how it is even more complicated than that very simple model that I would expect to be the case.

Mr Pickford: We are obviously continuing to argue very strongly our case in the working groups that are currently considering these proposals. We continue to insist with the Commission that they need to put in place workable mechanisms to ensure that the original intention of the June Council, which is that there should be no actions which have any actual or potential fiscal consequences that could be a result of an action of the ESA. So we continue to press this case and we believe a number of countries also support us in that.

Q22 Lord Trimble: Using the terminology "we continue to press the case" carries with it the implication that you may not succeed.

Mr Pickford: We will indeed continue to insist. Ultimately, though, you are right that these decisions will be taken potentially by Qualified Majority Vote.

Q23 Lord Trimble: So you will fail?

Mr Pickford: We do not think that failure is ---

Q24 Chairman: Minister, it will not surprise you to know that this is the point on which much anxiety has been expressed.

Lord Myners: Yes.

Chairman: And on which I shall be asking for comfort in my opening speech tonight; just a little flag.

Q25 Lord Haskins: So when you add it all up is it going to make much of a difference – that is the real question? I can see a lot of information being exchanged around the table and lots of notes and people talking to each other more than they are perhaps talking at the

moment, and that is the positive side and obviously that is good. But then you get into the issues of cultural differences country by country about the regulation and how it is implemented. You then say that the Risk Board has to point its finger at specific issues – you cannot just make planned statements – if I come back to the Irish banks and the Icelandic banks – and say, “Something must be done here.” They might even have to go further and say not just something must be done but to describe the nature of what needs to be done, which leads them into fiscal remediation about which they have no powers. So it seems to me that the overwhelming responsibility after these reforms for financial regulation is going to remain with nation Member States.

Lord Myners: Correct.

Q26 Lord Haskins: They are. So this is just a little bit of PR?

Lord Myners: No! Perish the thought! I think that these are very serious proposals which have the potential to be enormously helpful. Financial problems or the next financial crisis could be purely national, within a European Member State, but it is much more likely to have implications across a number of borders, as we are seeing, for instance, at the moment with the Baltic States and the consequences of that for Scandinavian banks. So I think that the creation of an architecture with the Risk Board and the supervisory authorities will make us much more alert to the potential build-up of risk. They will encourage debate and discussion, the sharing of anxieties, the development of mitigating responses; and, at the ESA level, the enforcement of Community rules and the co-ordination of individual national regulatory bodies. So I think my first answer was correct and I probably should have stopped. It is quite a lot more, Lord Haskins, than PR.

Q27 Lord Jordan: If the supervisory bodies identify an institution in a country that is genuinely doing something that could be a real systemic risk and the country itself either does

not solve it or does not want to solve it, what do you see as the measure of last resort by the European agencies?

Lord Myners: I imagine that as the last resort this is something that would be escalated to ECOFIN, to the European Council; it is likely also to have received the attention of the IMF and the FSB. I would like to say that I cannot find a situation, Lord Jordan, in my mind where I would envisage that an individual institution had become such a source of systemic risk to Europe that the combined pressure of European nations, EU institutions and global institutions would not be sufficient to bring corrective action. I am trying to imagine it but I can see effectively that it would become a pariah institution with whom others would not be willing to do business; and where it was so profoundly obvious that that was the case I imagine that the withdrawal of business connections would have been a progressive feature in any case.

Q28 Lord Moser: If a national bank or institution “misbehaves” or goes beyond this the only way that these European organisations would know about it is if the national institution has brought it to their attention. So it would mean that the national supervisory institution has already failed to discipline a particular bank, so they go to the European level. Is that how the European bodies would actually know about it?

Mr Pickford: If the institution under reference is one that operates across a number of EU Member States, then there is likely to be a supervisory college in place to bring together the supervisors from the relevant states where that institution operates. If you got into a situation where the home supervisor was at odds with the host supervisor in how to deal with this institution then the ESAs would have the ability to judge between what was the right and wrong approach, and in certain circumstances could resort to binding mediation if there is still disagreement. So I think that there is a structure within the legislation and within the arrangements which would allow for that European dimension to be brought to bear directly.

Q29 Lord Trimble: Skipping from the European Union for a moment and looking at the global situation, how do all these things fit together globally?

Lord Myners: I think that they work together rather as I sought to explain earlier and I do not think that there is any issue here that would suggest that one body was subservient to another but you have the IMF and the Financial Stability Board. The Financial Stability Board I think is making very good progress. The Chairman of the Financial Stability Board, Mario Draghi, is giving a lot of drive and force to that and I am delighted to see that Paul Tucker from the Bank of England and Adair Turner from the FSA are clearly very active and respected contributors to the FSB's work. So the FSB and the IMF from a global perspective, you have the European arrangements consequent upon the recommendations of Jacques de Larosière looking at things from a regional perspective. Then, as Lord Haskins quite correctly identified, the primary agent still for identifying systemic risk and individual institutional risk potential must lie with national regulators and national central banks and in that respect we have given the Bank of England a systemic financial stability responsibility and we are giving that to the FSA under the upcoming legislation, and the new Council for Financial Stability is already operating in shadow form, which I think will represent a much stronger bringing together of fiscal, central bank and regulatory authorities for domestic risk and domestic regulatory institutions.

Q30 Lord Trimble: So looking at this global structure is it going to tackle then the underlying global problem, which was the basic cause of the credit crunch, namely the financial imbalances which continued an unsustainable boom in Europe and the US for years longer than it otherwise would have done so? And if it is not doing that then it is inevitable that in another five to ten years we will be back in the same hole.

Lord Myners: In my own mind I do not think one can ever quite get to what caused this great financial crisis. It strikes me as being like a Russian doll and there always seems to be

another doll inside and for a while we stopped at the “sub-prime debt in America” doll and decided that that was a good point, but clearly there were others inside there and they lay with global imbalances. I would venture to say that even there one goes on further and addresses why in the developed world we seem to have lost the ability to defer gratification and we need a consumer-based society that is satiated immediately, and in the developing world under-consumption, under-investment and too much export activity. Clearly those global imbalances will need to be addressed and the Prime Minister has been through his leadership of the G20 at the absolute forefront of requiring the G20 and international institutions to confront the reality that these global imbalances are, if we are not careful, the source of continuing financial sector instability.

Chairman: Thank you very much, Lord Myners. I am now going to give you a minute’s break whilst we switch over and start asking you questions about the report on which we are currently engaged, which is Alternative Investment Fund Managers.