

To: Distribution

From: Andrew Hilton

December 5, 2011

Minutes of the CSFI Advisory Council Meeting, held on November 21 at Watermen's Hall, 16-18 St-Mary-at-Hill, London, EC3R 8EF.

A list of those attending and a copy of the (brief) agenda are given as Appendices 1 and 2.

Although John Plender, chairing the meeting, suggested that the first topic for discussion should be the unfolding eurocrisis, the discussion began with a couple of digressions that are worth following up:

- Ed Bowles suggested that the CSFI should look at the potential for London to become an international hub for trading in the renminbi (RMB). He noted a recent joint UK-China policy paper on this subject. No problem: we will try to set up an initial round-table.
- Kathleen Tyson-Quah focussed on Vickers – and specifically on whether it is possible to devise firewalls that actually do restrict contagion. Although we discussed Vickers subsequently, Bowles chipped in with the point that Kay Swinburne has also made: that some of Vickers's recommendations are incompatible with EU Directives/Regulations.

Turning back to the eurocrisis, it was pointed out (by Angus Hislop), that one of the big problems is that things are moving so fast that there simply isn't time to devise well thought-out solutions.

That said:

- Are the new supervisory agencies (EBA, ESMA and EIOPA) functioning as well as they could? (Plender).
- Are we moving towards financial protectionism in Europe - including, in particular, capital controls? (Peter Norman).
- Should we look at "the nitty-gritty of a possible break-up" – particularly the pressures that will build up ahead of time in FX markets? (David Lascelles). Andrew Hilton also noted that Nomura has recently produced a report on the implications of a eurozone break-up – and other banks may follow.
- Con Keating suggested an approach to Rosa Lastra, to discuss the legal issues surrounding a possible euro break-up.
- Stewart Fleming wondered how, and to what extent, the UK would be affected by measures taken within the eurozone to defend the euro.

- Brandon Davies wondered whether it would be possible to get a clearer reading of what is/is not permissible under Germany's constitutional law.

Finally, Plender suggested a broader historical point of view. What other currency unions have broken up, and how? Perhaps we could get an economic historian to speak – e.g. Richard Roberts (King's College, London)?

Turning back to Vickers, Hilton explained that the *Views on Vickers* report was just about to be published. But that doesn't mean that we should not cover issues related to the Commission's recommendations. A number of potential topics came up:

- Should we have a lighter regulatory regime for smaller and/or community banks? (Davies) There was agreement that conventional regulation inhibits competition and is a big barrier to entry. (Tyson Quah also worried about what she called 'scale bias' in *Vickers* – and, indeed, in current attitudes to regulation more generally.)
- This led to a discussion of new entrants – and new business models. One interesting new entrant in the UK is Simple (formerly BankSimple); in the UK, we have Zopa and Nick Hungerford's Nutmeg. At the moment, some peer-to-peer internet-based services effectively escape regulation altogether; others risk being regulated out of existence before they get started. (An interesting point was whether one of the big High St lenders could essentially steal the Zopa/Prosper model, and operate a large-scale peer-to-peer lending platform of its own.)
- Clearly, the biggest issue with *Vickers* is what can go in/what must stay out of the ringfence. Several speakers pointed out that apparently simple retail products (e.g. fixed rate mortgages) may in fact be extremely complicated and may involve sophisticated hedging tools.
- Lord May flagged a recent article (in the *AmJofA&S*) on the cost of financial services, and the way that the share of US corporate profits attributable to the financial services sector has increased in 30 years (from 10% to around one-third).¹
- Plender worried about potentially perverse incentives. Will *Vickers* (if implemented) simply push bankers into taking more risks to produce the returns to which banking has become accustomed? This is also the point made by Gene Rotberg in *Views on Vickers*.

The discussion on *Vickers* segued into a broader discussion that covered:

- Social issues/inequality: Should the CSFI look at the OWS/ST Paul's demonstrations? Growing income inequality? The apparent disconnect between risk and remuneration? (Jane Fuller noted the report by the High Pay Commission, chaired by Deborah Hargreaves.) Did 'Big Bang' itself contribute to this? Are financial institutions now "too damn big" (as one speaker said)?

¹ I am still trying to access a (free) copy of this article, which is in the Fall 2010 issue of *Daedalus* (I think) – an issue which also has an article by Charles Goodhart on monetary policy.

- Subsidies: There was a fascinating but inconclusive discussion about the level of explicit or implicit subsidy enjoyed by suppliers of regulated products - £150 billion/year on ISAs, for instance. Does this unfairly discriminate against those who are trying to get new products off the ground?
- The shadow banking system: Does it make more sense to try to regulate it (potentially, regulate it to death)? Or should we encourage it to expand, on the grounds that institutions operating in this area generally do not pose a systemic threat?

That, in turn, became a discussion of European (and international) regulation.

Jerry English began by worrying about the unintended consequences of Basel 3 – specifically a collapse of credit, when/if banks find they cannot raise the new capital they need in the markets. He pointed to a new financial specialty: the liquidity broker. Pre-crisis liquidity was underpriced: now (for many) there is no liquidity.

Other regulatory measures that speakers flagged as needing to be watched included:

- MiFID/EMIR;
- the proposed Financial Transactions Tax;
- CRD4;
- the crisis management Regulation (which will be out in the next couple of weeks); and
- new rules for G-SIFIs (all the main UK High St banks should be G-SIFIs).

In addition, as Norman pointed out, there will be a raft of new regulations in the clearing and settlement space. It was noted that Paul Tucker chairs the G20 Committee on CCPs - and that CCPs are not naturally self-regulating organisations. Indeed, they tend to be owned by a small group of institutions.

That led to a discussion of high-frequency trading – a source of great concern, particularly for Plender.

The first issue is whether (or to what extent) it poses a systemic threat. The second issue is why HFT is so profitable – and who gets the money it makes. The third issue is whether market integrity is being compromised.

It was noted that the Government's Foresight programme published a paper on HFT in September². Perhaps we should get the authors to explain its conclusions (which were basically favourable to HFT). Fuller wondered why the authorities' response on HFT has been so 'flabby'. Are exchanges becoming excessively dependent on the fees generated by HFT – to the detriment of their

² The Foresight programme has actually published several reports on HFT, including: "Crashes and high frequency trading" DR7; "High frequency trading, information and profits" DR10; and "the future of computer trading in financial markets (which appears to incorporate conclusions from the two prior papers).

standards? Hugh Savill noted that the latest draft of MiFID makes an attempt to tackle some of the most egregious problems related to HFT.

There is also a question of governance. The growth of HFT can be seen as another nail in the coffin of conventional capitalism. As Bob Garratt pointed out, “there is no time for ownership”.

The other big issue that was raised by the Advisory Council was the broad one of retail finance.

What particularly interested the group was the world of social media. All banks are now on Facebook and Twitter – just as they had a presence in (say) Second Life a few years ago. But are they doing anything creative or useful? Are they developing any products that are specifically tailored to the new media? The big interest lay in Facebook credits: How popular are they? What can be done with them? What plans does Facebook have for expanding their use?

Finally, Tyson-Quah brought us the Danish mortgage model, suggesting that this is worth looking at – again.

Any further thoughts or topics that we should look at more closely – or items that I missed from the Advisory Council discussion – will be gratefully received.

Meeting of the CSFI Advisory Council with John Plender.

**Monday, November 21, 2011, from 6:30-8:15pm
At Watermen's hall, 16-18 St Mary-at-Hill, London, EC3R
8EF.**

Chair

John Plender

CSFI

Andrew Hilton	Director
Jane Fuller	Co-Director
David Lascelles	Senior Fellow
Lisa Moyle	Programme Coordinator
Nick Hoar	Funding Coordinator
Peter Norman	CSFI/DTCC Post-trade Fellow

Corporate members

Edward Bowles	Standard Chartered
Stefano Carcascio	Bank of Italy
Brandon Davies	Gatehouse Bank
Hugh Savill	ABI

Individual members

David Clark
Jerry English
Stewart Fleming
Jonathan Howitt
Alan Judes
Con Keating

Guests

Simon Deane-Johns	
Angus Hislop	Cisco
Nick Hungerford	Nutmeg
Andrew Marshall	Fishburn Hedges
Lord May	Oxford University
Richard McManus	Third Horizon
Richard Perrott	Berenberg
Kathleen Tyson-Quah	Absalon Project

CSFI Advisory Council

November 21, 2011.

Agenda

In my original invitation, I listed as possible topics for discussion:

- the rolling eurozone crisis;
- Basel3/CRD4;
- other European legislation (Solvency2, PRIPS, the FTT, etc etc);
- regulatory restructuring in the UK and elsewhere;
- high-speed trading; and
- SME finance.

That still looks a pretty good list - though we may have to find a new angle on the eurozone crisis.

Other issues that have been brought to our attention include:

- the long-term sustainability of global mega-banks who are ultimately dependent on domestic regulation (Mark Tennant);
- CCPs – “the next too-big-to-fail” (Richard Metcalfe);
- has the regulatory pendulum swung too far? (Bill Dalton);
- does the FSB have the capacity to do what the G20 has asked? (Angus Hislop);
- newer forms of retail finance distribution – especially social media and video (Hislop);
- tax incentives for “really small businesses” – can we simplify the rules? (John Chown);
- revisiting the “hard ECU”, originally put forward by Paul Richards (Adam Ridley); and
- can one stop banks shrinking assets as a response to the regulatory burden? (Ridley).

A.H.

November 21