Getting Brussels right: “Best practice” for City firms in handling EU institutions

By Malcolm Levitt
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Foreword

Malcolm Levitt is a euro-watcher from way back – and not only a euro-watcher. From his days at Ernst & Young and at Barclays, he has made a real contribution to the single market in EU financial services and in bringing Lord Cockfield’s vision to life. In that sense, the City of London has a lot to thank him for.

But Malcolm is not entirely happy with what he sees today in either London or Brussels.

He is by nature cautious, certainly not a boat-rocker. But this report is the product of a deep and growing concern that the UK financial services sector is not engaging with the powers-that-be (and that soon will be, once the European Supervisory Authorities are up-and-running) in the EU as effectively as they might.

This is not a blanket criticism (God forbid); there are – as Malcolm is keen to emphasise – some UK firms that do a very good job of engaging with the EU. But there are, unfortunately, plenty of others who don’t get it right – particularly in comparison with their Continental peers. In this report (which is the product of 68 interviews and a lifetime of professional experience), Malcolm identifies a number of crucial weaknesses to which he believes City firms are prone. They include, in particular:

- a reluctance to deal ‘proactively’ with the EU institutions, which often means that City firms engage too late with what is going on to have a constructive impact;
- a failure to appreciate that reciprocity is at the heart of effective engagement with Brussels – that MEPs and officials respond better to pleas for help if the firm asking for help has provided it in the past;
- a reluctance to build alliances, in particular with Continental firms, and to get the message across that the City is a European resource as much as a UK one; and
- a congenital aversion to the so-called “vision thing” – which often stops City firms from understanding what drives the authorities in Brussels.

Malcolm offers his own thoughts on what he sees as “best practice” for City firms in dealing with the EU. He also proposes a more positive role for the Treasury and the FCO; the latter, in particular, could be enormously helpful in providing a new source of information and insight to City firms.

I am grateful to Malcolm for putting his thoughts down on paper – and for letting the CSFI publish them. There are very few people in the City with his depth of knowledge of how the Brussels Leviathan actually works. Sometimes, I wish he had been more willing to ‘name and shame’, but that is not the way he works. So, one has to read between the lines as well as what he writes - and what we then have is a picture of missed opportunities. Fortunately for London (and the UK), it is not too late to get it right.

Andrew Hilton,
Director
CSFI
Summary and conclusions

Introduction

The City faces unprecedented regulatory and supervisory challenges from EU initiatives. Many firms need to raise their game by emulating the best - which includes firms in other, non-City sectors. This study, undertaken on a personal basis, looks at how City firms engage with the EU - and at their effectiveness. It is based on 68 interviews conducted on the basis of anonymity. It has come about as a result of my deep concern at how well we are responding to the challenges of a more difficult political environment in Europe.

Like it or not, the City is a strategically important element of the British economy, and we cannot afford to get it wrong.

As one official put it to me:

“The nature of the game has changed. What might have been good enough in the past, where national discretions were built into Directives and offered some flexibility, will no longer work. The new European Supervisory Authorities will issue detailed mandatory standards, and the industry must organise itself to provide the best data and analysis possible to support its submissions. It will only have itself to blame if the rules are poor - bearing in mind the risk of the UK being outvoted, especially if its arguments are not well supported by good evidence from firms.”

Context: The battle of philosophies and competition between financial centres

European regulatory and supervisory initiatives stem partly from global responses to the financial crisis. However, they are also the latest stage in a continuing battle between rival regulatory philosophies and competition between financial centres. They are therefore illuminated by earlier attacks, unfamiliar to some now in the City, on “casino capitalism”, by contests over the single passport for banks and third country banks’ access, by attacks on the London Stock Exchange’s European scope and by attempts to block the City’s activities because the UK is outside the euro area. Given the widespread belief that the UK’s regulatory and supervisory approach was an important factor in the City’s attractiveness, confrontation was predictable as soon as an opportunity arose - particularly in those areas where UK regulation is materially different from that in, say, France or Germany, or where wholesale business done in the City is significantly larger than in those countries.

As one eminent figure put it to me, “the crisis has given them a once in a lifetime opportunity to fix the rules to their liking”.

“The City will only have itself to blame . . .”
What are the lessons to be learned?

1. **Timeliness:** Officials and MEPs repeatedly stressed to me the importance of timely awareness of potential policy developments. Upstream engagement in the debate during their gestation and action during the drafting and legislative stages are essential. Pressures from other national capitals and the evolution of MEPs’ “own initiative” opinions should be closely watched. There should be no surprises.

The saga of the Alternative Investment Fund Management Directive (AIFMD) illustrates shortcomings in all these respects. Unfortunately, supervisory developments also reflect many of them.

2. **Over-lobbying:** Several City people expressed concern to me that the sum of all their efforts might be perceived as “over-lobbying” – and therefore, as irritating to MEPs and officials. There is some truth in this. While some on the “buy side” said “the more we hear the better”, several confirmed the perception that “they mistake access for effectiveness”. In my opinion, the problem reflects a failure to evaluate effectiveness, as well as weakness in prioritising issues on which to campaign.

3. **Quality of submissions:** A few UK firms have a consistently good reputation for high-quality assessments, reflecting CEO-driven engagement in regulatory impact analyses. But others confessed that getting the relevant parts of the business involved is a struggle: “Getting the engagement of the businesses is my hardest task.”

MEPs and several officials emphasised that, although some City submissions are excellent, there is often not enough detailed or focussed evidence in much of what they see and hear. The persuasiveness of representations inevitably varies with the rigour of the business impact assessment.

There is a view in the City that much recent EU legislation is rushed and open to alternative interpretation, and that there is too little time for response or consultation. “The Commission’s ‘better regulation’ agenda seems to be dead.” Again, there may be some truth in that. For instance, an official conceded to me that “There is now more impatience to get legislation adopted. Firms need to reiterate to the Commissioner the benefits of effective consultation.”

There is no doubt that persuasive presentation of a firm’s case is crucial. A leading non-City corporate emphasised that “the approach should be constructive in tone - acknowledging or seeking to explore the alleged problem giving rise to a proposal, and suggesting ways of tackling it”.

A number of comments were also made to me about the City’s arrogance, its emphasis on costs while ignoring potential benefits, and its special pleading - even when firms in other sectors would suffer as much from the regulatory changes as the City. One non-City firm stressed the need for focussed and timely efforts to get the
engagement of such firms, and for a willingness to utilise independent consultants to demonstrate the impact of a particular measure beyond the financial sector.

The City’s mantra, that “We are global, not simply European”, is also taken by some MEPs and Commission officials to reveal an unacceptable degree of dismissiveness towards EU ambitions and concerns. Clearly, those who believe in the City’s global role need to take a more nuanced approach.

4. **Building alliances:** Persuading individual EU governments of a firm’s case in other capitals - and monitoring those governments’ positions on EU issues - is taken seriously by few City institutions at the present time. However, its importance was stressed by several other City firms, by non-City corporates and by Continental banks.

In addition, a Continental bank and several non-City corporates pointed out to me that cross-national alliances, perhaps *ad hoc*, can be a very effective way of getting one’s message across, of building relationships and of exchanging information. However, very few City financial firms appear to participate in such arrangements - unlike firms in other sectors. As a result, their submissions are more easily dismissed as merely ‘Anglo Saxon’.

5. **Building relationships:** Non-City firms repeatedly emphasised to me that a firm’s ability to persuade MEPs and officials of its views depends on having good long-term relations with them - and that means that those who represent the firm should not appear only when they want something. Building relationships across the EU institutions is an area where the active, regular engagement of chairmen and chief executives is crucial - and where two Continental chairmen were repeatedly cited as being particularly effective.

6. **Think-tanks:** Commission officials and representatives of Continental banks agreed that policy initiatives often emerge from the ideas discussed in think-tanks in Brussels. In those fora, where ideas are floated, early warnings can be picked up and relationships can be built. Unfortunately, City firms rarely participate in such discussions.

7. **The “buy side” for submissions:** Almost without exception, MEPs insisted to me that City firms need to do much more to educate MEPs about their sector - including its broader contribution to Europe’s economy, not simply in terms of its employment, tax or contribution to GDP. They also need to engage more MEPs beyond the European Parliament’s Financial Services Forum, and to be prepared to help MEPs - and not simply to ask for things from them.

There is an inevitable suspicion of the Commission’s intentions by many City firms, but one Brussels-based consultant insisted that firms should be more prepared to be “proactive” in understanding officials’ concerns. In particular, they should help officials to understand the issues and make constructive suggestions before legislation is drafted. Again, they should not only see officials when they want (or oppose) something.
8. Firms and the UK government: Officials and firms both agreed that the UK government is likely to need more expert input from the City, particularly given the Treasury’s staff cuts. Concern was also expressed by some firms that the UK’s supervisory changes will weaken the continuity of its engagement with the EU. In addition, the absence of British participation in the EPP was said by several respondents to have eliminated an important moderating voice in one of Europe’s largest political parties.

A point emphasised by several firms was the lack of a strategic shared vision among firms and government on the future of the City and on what needs to be done to sustain its success. Meetings between the City and the government have hitherto been regarded as generally ineffective by both officials and firms – demonstrating little leadership and yielding neither strategy, action nor deliverables.

Effectiveness and proactivity

Effectiveness means being willing to change policy - whether reacting to an official proposal or proactively initiating one. While reactive effectiveness has been mixed, City firms admit that they are generally not proactive either in initiating new policies or planning for potential threats.

Centralisation of EU supervision

A trend towards the centralisation of European regulation and supervision is now predictably apparent via Regulations, rather than Treaty changes.

The issues raised by centralisation of supervision illustrate the shortcomings that I have identified with respect to City firms’ approach to the EU. They were late to appreciate the possibility of centralisation; the potential threat was not taken seriously; and they did not engage with the intellectual case for it. Their failure to analyse the nature and powers that the new supervisory bodies might have, as well as their legal base, meant that City firms were (and are) unclear how to secure their preferred outcome.

It is true that some City firms favour regulatory and supervisory centralisation because they believe that it should reduce compliance costs. But some of those do not seem to have addressed the question of whether centralization could have adverse implications for the attractiveness of the City and Europe as places to do business. At present, those firms that have taken a positive position on centralisation (on the grounds of potentially lower compliance costs) admit to simply hoping for benign philosophies, skilled regulatory and supervisory staff, and congenial operational practices. “A risky strategy”, as one admitted.
Best practice

On the basis of the interviews undertaken for this paper, it seems possible to describe best practice with regard to the European institutions and European legislation as involving:

- early, upstream engagement;
- rigorous business impact analysis;
- clear, disciplined positions;
- prioritisation of issues on which to expend political capital;
- a persuasive, constructive tone in presenting one’s case;
- involvement of business experts in meetings with officials and MEPs where technical issues arise;
- assessment of political positions in other members of the Council of Ministers and representation of the firm’s position in other capitals;
- participation in alliances with like-minded firms in other Member States on particular issues;
- engagement with firms in other sectors, as well as with end-users and investors;
- involvement of chairmen/CEOs in building relationships;
- proactively helping MEPs and officials to understand technical issues of potential concern; and
- being proactive in influencing the forward policy agenda.

Conclusions

What has emerged from my conversations with firms, officials, MEPs, non-City corporates and consultants is that City firms need to raise their game to the best practice of their peers and non-City firms. They can do this:

• through ensuring earlier engagement, as well as through better quality submissions and representations;

• by upgrading the skill-set devoted to EU issues to embrace public affairs/government relations staff, business experts and those familiar with authorities in other capitals;
by developing a formal, CEO-driven process to ensure that businesses respond in a timely and rigorous manner to major regulatory developments, and that their heads are held to account for their performance on significant regulatory issues;

by improving the persuasiveness of firms’ arguments in terms of tone - avoiding self-serving pleading, engaging end-users and other interested parties earlier, and using external economic or other professional consultants;

by engaging with authorities in other capitals;

by developing alliances with Continental firms on issues of common concern;

by recognising the benefits of building relationships - not turning up only when a firm wants something (the ESAs should be an important focus for this);

by putting more resources into providing data and high-quality input into the UK authorities; and

by recognising the benefits of being proactive.

Some issues for proactive effort are noted in the report below. For instance, firms should repeatedly stress the principles upon which supervision should be based, whatever its architecture, perhaps in alliance with Continental institutions.

It is important to appreciate that much of the above might involve collective action with others in the City.

City firms who do interact with the European institutions should also consider ways in which their effectiveness can be evaluated.

It isn’t just a question of getting City firms to handle “Europe” better. The UK authorities should also ensure that the UK is better represented in key Commission positions - giving better recognition to staff serving in Brussels, whether in the Commission or UKREP, than has generally been the case for decades past.

Finally, notwithstanding the global consensus in favour of more effective financial regulation and supervision, it is important for the UK to recognise that - given the hostility of powerful Member States to the City’s vision of a single market for financial services - the contest between rival regulatory and supervisory philosophies was always bound to flare up as soon as an opportunity for conflict arose. And the recent financial crisis provided ample opportunity for that conflict.
I Introduction

The City faces an unprecedented barrage of EU regulatory and supervisory initiatives. Unfortunately, the task of responding to these challenges is harder than before. In particular, the UK’s and the City’s credibility and influence in Europe have been diminished as a result of the financial crisis. British influence in DG Internal Market has shrunk in recent years. In addition, the legislative framework has changed from one of Directives (permitting a degree of national flexibility) to one of mandatory Regulations without national discretion. The outlook is worrying.

I have been induced to undertake this study as a result of my concern as to whether City firms, individually or collectively, are as effective as they should be in terms of:

- early identification of (and engagement with) European developments that have strategic implications for the health of the City;
- understanding the political dynamics driving EU initiatives, both in the European institutions themselves and in national capitals;
- defending themselves against damaging legislative proposals;
- involving business experts and public affairs people in preparing and presenting the most robust possible arguments to defend City interests; and
- engaging the attention of their top people on European issues.

I am also concerned that UK institutions may not handle Europe as well as many of their competitors in Continental Europe.

In principle, the current spate of initiatives from Brussels stems from the global response to the financial crisis, as agreed in the G20. In practice, however, it also reflects the latest stage in a battle between British and Continental regulatory/supervisory philosophies - together with continuing attempts by Continental authorities to repatriate business from the City. Given the differences in regulatory philosophy - together with the determination of other Member States to win business back from the City - it has always been clear to me that, sooner or later, challenges would appear from those who never bought into the City’s vision of a single market for financial services. My concern has been whether this threat is either recognised or planned for. As an eminent City figure put it to me:

“They have been given a once-in-a-lifetime opportunity by the crisis to fix the rules to their liking.”
These attacks on the UK were all too predictable. But were our defences in place? Or did complacency and contempt for the opposition rule?

As one experienced international observer has said to me many times over the years, “The City is the biggest financial centre in Europe, if not the World. But you are always reacting to someone else’s agenda.” So, a further concern is whether firms, individually or collectively, are being sufficiently proactive.

The importance of the City of London to the UK economy is, like it or not, comparable to that of the motor industry to Germany. If we get it wrong, the consequences for the UK will be disastrous in terms of jobs, exports, tax revenue and growth.

Over the last few months, a total of 68 people were kind enough to share their views with me (see Annex for categories of people seen). All the interviews were on the basis of anonymity. The conclusions are entirely my own, and I am responsible for any inaccuracies.
II Context: The crisis and the battle of philosophies

The financial crisis

As one official pointed out to me:

“It is important for City firms to realise that their influence and that of the UK have been weakened by the crisis. The ‘light touch’ approach has been discredited. A new system is coming - and it is in the interest of firms to engage with it constructively to make it work well.”

Another official put it equally strongly:

“The nature of the game has changed. What might have been good enough in the past, where national discretions were built into Directives (which offered some flexibility), will no longer work. The new European Supervisory Authorities will issue detailed mandatory standards, and the industry must organise itself to provide the best possible data and analysis to support its submissions. It will only have itself to blame if the rules are poor, bearing in mind the risk of the UK being outvoted - especially if its arguments are not well-supported by good evidence from firms.”

Another view, from a senior City figure, emphasised that there have always been those in Continental Europe who were uncomfortable with the City’s approach to regulation and the single market: “The crisis has given them a once-in-a-lifetime opportunity to rewrite the rules.”

Competing philosophies - and competition between financial centres

The European regulatory and supervisory initiatives facing City firms stem, in large part, from global responses to the financial crisis. But to some degree, they are also the latest stage in a battle between rival philosophies and in a competition between financial centres.1 Some who are now in positions of responsibility in the City appear to have little awareness of this context - which is why a brief summary of the record is needed.

1. For an excellent analysis see Political economy of financial integration in Europe, The battle of systems J Story and I Walter, MIT 1997
The launch of Lord Cockfield’s effort to create a single market for financial services in 1985 was based on three principles:

- minimum harmonisation;
- mutual recognition between national authorities; and
- home country regulation, enabling firms to do and sell throughout the single market whatever they were authorised to do/sell at home on the basis of their single home country passport.

These principles were endorsed by the UK - where the Thatcher government had a vision of the City dominating Europe’s financial markets - and by City firms.

That vision was subsequently summarised as:

- freedom of participants to raise and invest funds in all Member States;
- freedom for financial firms to compete within all national systems, with access to all essential infrastructures, on a remote basis if necessary;
- freedom for intermediaries to offer whatever services or products they were licensed to provide across the EU;
- freedom for market structures and infrastructures to evolve in response to market forces, competition and innovation; and
- an EU-wide market for corporate ownership.²

Such a vision was - and remains - anathema to some in Continental Europe.

Several countries had serious misgivings from the outset about the Cockfield report’s principles and what they implied: “Britain was seen as ruthlessly exporting its ‘Anglo Saxon’ preference for ‘casino’ finance.”³ In particular, they were concerned about the opportunities created for American banks and the vulnerability of their own. As one put it “....the Federal Republic will become a sports arena for foreign banks... they will demonstrate how to buy, sell and strip... on the American model.”⁴ The result was a number of battles.

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2. See Creating a single market for financial services, City of London 2002
3. Story and Walter p. 296
4. Walter Siepp, head of Dresdner Bank, Story and Walter, p. 293
Examples of these fights include:

- **The Investment Services Directive**: The French insisted that domestic shares should only be traded on a ‘regulated’ market - defined as one meeting strict requirements for ‘transparency’ (meaning revelation of pre-trade price, thereby threatening LSE’s quote-driven, market-making model) and listing rules (whereas the LSE was a trading body, not a listing authority). “It is important to recognise that the aim was to repatriate French share trading to Paris.”

- **The Second Banking Directive**: The single passport was weakened by insertion of a host country right to impose restrictions on grounds of the ‘general good’ and of monetary policy - the latter being the excuse for the French ban on Barclays initiative to pay interest on current accounts. There was also French pressure for restrictions on the access of non-European banks (including branches of American banks in the City) to the single market through strict reciprocity rules.

Later, potentially very serious, challenges to the City included efforts to use the UK’s absence from the eurozone:

- to exclude the City from access to intraday euro liquidity through the TARGET system; and
- to argue that the Regulation guaranteeing continuity of financial contracts following the changeover from national currencies would only apply to financial transactions within the eurozone.

Today, **history is repeating itself**. I would point to three recent developments:

- Certain Continental countries have always disliked cross-border, “passported” competition, so we are seeing pressure on banks to reconstitute their branches as subsidiaries.
- Restrictions on third country access have returned via the protracted negotiations over the hedge fund Directive (the AIFMD).
- We are seeing a re-run of euro-centric reasoning, with the argument that CCPs handling euro-denominated transactions must be located within the eurozone.

**Such challenges should come as no surprise**. Given the widespread belief that the UK’s regulatory and supervisory approach has been an important factor in the City’s success, an attack was predictable as soon as an opportunity arose - particularly in those areas where UK regulation was materially different from that in, say, France or Germany, or where wholesale business done in the City was significantly larger than in those countries.

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5. *European equity markets* Benn Steil and others, Royal Institute for International Affairs, 1996, p. 116

6. Story and Walter
III Early warning mechanisms

Early awareness of potential policy/legislative changes, engagement in the debate during their gestation and action during the drafting and legislative processes are all essential. Ideally, there should be no surprises. Pressures on the Commission and Parliament from national capitals and from “own initiative” opinions by MEPs need to be more closely watched.

At one extreme, we have the example of insurance - where, I was told, the industry’s discussions with British and Commission officials about the need for more effective and efficient regulation gave birth to the proposal for Solvency II. That is a positive example.

However, one Brussels-based consultant commented to me on City firms in the financial sector more generally: “Their engagement does not always appear to operate in a planned way, embracing ‘upstream’ developments.” His words were almost identical to those of the head of a non-financial trade association, who said: “There is not enough upstream involvement by City firms.”

In contrast, a number of Continental banks were repeatedly cited for their early engagement – including in particular, Deutsche and UniCredit.

These perceptions were shared by several MEPs and officials. A few UK firms are prepared to get engaged in EU developments over a prolonged period, but this seems to be the exception. It may reflect the shortage of resources in some City firms.

“Upstream” activities, in which Continental institutions tend to be more involved than City firms, include:

- discussions in Brussels think-tanks, where Commission officials sometimes expose their forward thinking; and

- statements and debates in other national capitals, including speeches and articles by national politicians and other key players or commentators.

Several officials, MEPs and consultants told me that City firms do not seem to understand the power of MEPs to request the Commission to draw up legislative proposals on the basis of Parliamentary “own initiative” opinions. It is worth emphasising this power. Art.42 of the Parliament’s Rules of Procedure reads:

“1. Parliament may request the Commission...to submit to it any appropriate proposal for the adoption of a new act or the amendment of an existing act, by adopting a resolution on the basis of an own-initiative report....

7. For instance, Bruegel and CEPS have had working groups and discussions on the theme of financial regulation and supervision for several years.
2. Any Member may table a proposal for a Union Act on the basis of the right of initiative granted to Parliament...."

There has been a tendency - according to officials, MEPs and consultants to whom I spoke – for City firms to be dismissive of radical “own initiative” opinions. That is unwise. As one MEP stressed “firms really need to be more involved in ‘own initiative’ opinions, and to follow them closely”.

A good example of this was the highly critical April 2008 Rasmussen report on hedge funds and private equity. It was not taken sufficiently seriously by many firms. Nor did they seem to have appreciated the pressure on the Commission from France and Germany. This is all the more serious given the AIFMD’s potentially adverse implications for both the sell and buy sides.

**The AIFMD farrago:**

- Firms claimed to have been caught by surprise by the AIFMD, insisting that the time for consultation was far shorter than the Commission’s “better regulation agenda” required.
- However, one highly respected City EU expert admitted of the AIFMD, that “we woke up late”.
- Officials point out that City firms did not seem to understand that the Rasmussen report was not simply the work of one cantankerous MEP, but that it had the backing of the three largest parties in the EP. It had also been under discussion for several months prior to adoption, and firms were warned that Barroso had promised the Parliament that a proposal for a Directive would be adopted by the Commission by the end of the Parliamentary session in 2008.

That said, the claim that the time allowed for consultation - and the concern that the Better Regulation principles appear to have been suspended - appears valid. Even so, Commission officials argue that City firms did not grasp the political dynamic. They should have appreciated the political pressure from MEPs, France and Germany for speedy action - notwithstanding their counter-argument that there was no “objective” case for urgency and that hedge funds and private equity had not caused the crisis.

Some officials and firms insist that the AIFMD episode was not typical (especially as this was a sector unaccustomed to regulation). Nonetheless, the proposal had implications for City firms more generally, and it illustrates issues that are present elsewhere.

Also, the AIFMD incident highlights another issue: the significance of other national capitals. The former head of government relations at a non-City corporate stressed the need to keep abreast of opinion in other European capitals for an early warning of political pressures on the Commission and of Council positions: “An important element of my job was maintaining close political relations with governments and authorities in other Member States.” This was echoed by another non-City firm, where the local business head in different EU states is required to watch regulatory and policy developments closely. This requires good political contacts and awareness of what key people are saying in speeches and articles.
IV Determining business impact

Getting feedback from the firm’s businesses, determining the impact of a proposal, deciding on the firm’s position and agreeing action are all essential elements in responding to developments in Europe. But the key is getting the businesses themselves involved in assessing the business impact of a proposal. Here, the record of the City is mixed. Although some officials and MEPs praised the high quality of submissions by City firms, a very uneven picture emerges. As one senior official put it: “The quality is highly varied.”

My own experience in writing this paper confirms this.

At one British bank, I was told: “The businesses must take ownership of the issues.” However, another said: “We are not experts; it is for the businesses to establish the impact - although if we feel they might be missing something we sometimes challenge them.” Another (British) bank said that: “The CEO has a mandatory weekly conference call on regulatory issues with the heads of central functions and businesses to discuss the business implications, our position and to establish who is to take the lead on issues.”

That sounds good, but a Continental bank told me that its process for determining the business impact of developments in Europe is far more formalised: “A written protocol specifies that businesses must respond to the EU regulatory affairs director within two weeks... the handling of regulatory affairs is part of the annual performance and bonus review of business heads.”

There are certainly UK firms who do it right. For instance, one City firm told me “It is never a problem getting the engagement of the businesses, and their experts recognise the need to go to Brussels.”

The global director of regulatory affairs at one large non-City firm in an unpopular sector, who sits on the firm’s management committee, also took the same line: “The businesses regard regulation as a crucial factor in their production, distribution and marketing.” Probably uniquely, staff from those businesses are rotated through his department for 2-3 year postings, leaving on promotion.

However, that is not the rule. For instance, at one investment bank, I was told: “Getting the engagement of the businesses is the hardest task - harder than dealing with people in Brussels. Their engagement needs pressure down from the top.” Another (non-bank) interviewee told me: “I do not know what the businesses make of it.”

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8. Some banks were praised for the technical quality of their submissions, including Barclays, Citi, Deutsche, Goldman Sachs and JP Morgan.
This is not a criticism of the regulatory affairs teams at their institutions as committed or skilful individuals. But they cannot be expected to be experts on all aspects of their firms’ often complex businesses. Most of those I talked with stressed that the businesses trust their judgement – but, although they circulated draft responses/position papers to the businesses, they did not get much by way of feedback.

One cannot be certain, but it does appear that, in cases like this, the regulatory teams are less likely to incorporate quantified business impact analyses into their submissions to MEPs and to the Commission. One MEP, for instance, complained that:

“Sometimes they just cannot say exactly what the impact will be in quantitative terms - although it should not be impossible to calculate. They also cannot point out exactly which words in the draft give them a problem. Their public affairs, legal experts and business people need to get much closer.”

I was told of City firms where the regulatory affairs officer cannot get the engagement of the firm’s business experts - who nonetheless sit on industry working bodies. The two groups may actually not know one another until introduced through their trade association. One hopes such instances are rare.

Where business engagement in responding to regulatory challenges is not in a firm’s DNA, there is a strong case for a formal, CEO-driven process to ensure that businesses respond appropriately to major regulatory developments, and that their heads are held to account on regulatory issues. As one global head of regulatory risk put it, “Governments and regulators are among the biggest sources of risk facing financial firms.”
V The firm’s position

Fixing a firm’s position on regulatory developments and resolving internal differences are essential, but practice varies.

Determining a firm’s position often involves an iterative process, embracing the public/regulatory affairs or regulatory risk officers, the businesses themselves and appropriate other central functions, such as legal, compliance etc. On major developments, the CEO and/or chairman may also have to be involved.

In firms where business engagement with regulatory issues is weak, it usually seems to be up to the public and/or regulatory affairs/risk team to propose a draft position on which businesses are invited to comment, sometimes without much expectation that they will do so. That isn’t really good enough. In contrast, at one City firm, it is the global head of regulation who signs off on a position, even where the business head has endorsed it.

It is important to appreciate that a single regulatory change might well have different impacts on different business lines, and firms seem to handle this in a variety of ways. For instance, one head of regulatory risk told me: “The silo mentality of this place means that businesses feel free to take a different position from that ostensibly agreed for the group when dealing with officials. And we have no common position across our global regions on Basel.”

However, another insisted: “It is legitimate for businesses to disagree within the firm about impact and the position to be taken - so long as they toe the group line publicly and in dealing with officials.” That was also the view of those with the strongest CEO engagement. Where serious differences of opinion exist on regulatory issues that have a potentially serious impact on a firm, a common (but not universal) practice appears to be to escalate the issue to a senior management level for resolution.

Another said that the determination of the firm’s position depended on the business importance of the issue and whether it was relevant to just one business line (in which case, that business could be free to make up its own mind) or whether other businesses were affected (in which case, the issue might be taken up at a senior group level).

One director of regulatory risk at a universal bank said that the CEO takes a close interest in any position taken by a business on regulatory proposals; he takes account of the public policy issues with which the firm is dealing and has been known to decree: “We can live with this, I know business X will suffer but we have other things to fight so let’s not waste political capital on this one.” Such an approach reduces the risk of over-lobbying.
VI The quantity of submissions: over-lobbying?

Several City figures expressed their concern to me that the sum of all their efforts, including meetings and written submissions, might be perceived as over-lobbying – and, therefore, as irritating to MEPs and officials.

The evidence on this is mixed. Several ‘buy-side’ respondents confirmed the perception, while others insisted that “the more we hear the better”. It appears that the quantity of information offered needs to be tailored to the appetite of the particular official/MEP being addressed.

It is certainly the case that City firms, trade associations and bodies such as City UK are frequent visitors to the EU institutions. So a lot of contact is made with MEPs and Commission officials. Some of those to whom I spoke were concerned that this might be overkill. But it is also the case that the City will be more affected by EU proposals than elsewhere, and that City institutions will, therefore, have more issues to discuss relating to any single Directive than institutions from elsewhere. The problem - insofar as it exists at all - is with the number of submissions and meetings dealing with the same issue.

One very influential MEP was adamant:

“I like to get the full flavour of all the arguments and positions. But some of my colleagues, with a corporatist background and mindset, prefer something presenting the collective view of the European industry on an issue. However, the debate can evolve so quickly that by the time the European industry has agreed a position, matters have moved on.”

That MEP also claimed that the sheer volume of lobbying that the Parliament gets from some other sectors - “especially the German motor car manufacturers” - is much greater than comes from the City.

All Commission officials to whom I spoke stressed that they value contact with City firms because it enables them to get important information and because it is useful to hear City firms explain their own reasoning. But two expressed irritation at the number of people wanting to see them to convey identical messages:

- “Some people seem to think that, if they are in my office every week, they will be better understood and more effective. But they are irritating and counterproductive.”

- “We find that several of us have been seen on the same issue by the
same person with the same message on the same day, and it is especially irritating to find that they are seeing the Deputy DG without telling us – or without telling him that they have seen us.”

This isn’t just a problem with the UK; some Continental firms are equally to blame.

Some of the City people to whom I spoke wondered whether an effort should be made to coordinate proposed visits to Brussels, so that the total number of such visits is cut, with a few firms speaking on behalf of others. At the same time, however, while most respondents acknowledge the representational role of trade associations, most also wanted to retain their own right to make submissions given that different firms have different business models and interests.

A number of firms also made the telling point that sometimes, following formal consultation, the Commission quotes the number of submissions it has received making a particular point, and the number taking a contrary position. This can be taken to imply that the more submissions there are, the greater will be the weight put on them, irrespective of such considerations as (for instance) the market shares of those on either side of an issue. This concern can lead to more individual submissions, rather than consolidated joint submissions.

For their part, Commission officials insist that it is reasonable to show the number of submissions received – but that it is the quality of submissions that counts, rather than their length or number.

At any rate, several of the firms to whom I spoke believe that the Commission should be more transparent about how it balances the various positions taken in the submissions it receives, and on the basis of what criteria.

A very experienced and respected consultant on EU developments to whom I spoke had a rather different view, emphasising quality over quantity:

“"It is not so much the amount of time put into seeing MEPs and Commission officials, including the number seen, but the willingness to devote sufficient resources to rigorous analysis of the issue - including assembling quantitative evidence about the impact on the business. Too few firms are prepared to do this.”

Another shared the same concern, suggesting that: “The problem might arise from the way in which performance is measured: the more people seen and the more often, the better the public/regulatory affairs officer’s performance, not their impact on policy.”

As one British official put it: “They mistake access for effectiveness.” Another factor might be problems in prioritising the issues on which to focus attention.

That comment takes us to the question of the quality of the submissions, written and oral.
VII Quality and persuasiveness

The quality of submissions, written and oral, including their persuasiveness, is crucial to achieving effectiveness. The term ‘quality’ embraces the rigour of the reasoning, its objectivity and the supporting evidence, quantified wherever appropriate. Several officials and MEPs expressed praise for the quality of some of the submissions they have received from City firms. However, they stressed that there was not enough detailed or focussed evidence in much of what they see and hear. In the opinion of several officials, the persuasiveness of representations varies with the rigour of the business impact assessment. As one UK official put it, “the quality is very varied”. But firms also need to reiterate the benefits of the Commission’s ‘Better regulation agenda’.

Quality of submissions: business impact assessment

Both the Commission and Whitehall are often criticised by the City for the inadequacy of their own impact assessments. But, as one bank’s EU regulatory risk executive put it: “We are not in a negotiation, we are on the receiving end.” So it is up to firms to deploy the best arguments and evidence they can, while pressing the Commission for better impact assessments. As noted earlier, the degree to which businesses and their experts are prepared to get engaged with regulatory developments is varied – and that can present a challenge to public affairs/regulatory risk teams.

One Commission official pointed to a heap of submissions on a matter under consultation on his desk, and said that it was only a third of the original heap - the rest having been binned as too superficial to be of use. Officials, a City person with considerable experience of writing and reviewing submissions and several consultants all emphasised to me the need for more professionalism and objectivity – and for more rigorous business impact assessments.

Some in the City to whom I spoke suggested that careful, quantitative assessment of the business impact of proposals has become more difficult recently because key legislative proposals appear to have been rushed through in response to political pressures. As a result, their impact is difficult to determine given the alternative interpretations that can be put on them. Moreover, it seems that too little time has been allowed for consultation and response. There appears to have been a rowing back from the Commission’s “better regulation agenda”, which promised sufficient time for consultation and for a rigorous cost/benefit impact analysis of new proposals. One firm said “the Commission’s better regulation agenda seems to be
dead”. An official conceded that: “There is now greater impatience to get legislation adopted. This threatens its quality and the credibility of the regulatory system - and firms need to emphasise this to Commissioner Barnier.”

Some respondents made the point that quantitative business impact assessment is genuinely difficult - especially when behavioural change is involved. Nonetheless, a few firms do have a consistently good reputation for high quality assessment, and this reflects the resources they devote to regulatory issues (including the engagement of their businesses).

**Expert representation at meetings**

As for oral representation to the European institutions, officials stressed the need for executives to be accompanied to meetings by relevant experts when technical issues are likely to arise. Unfortunately, this is not always done. One Commission official told me: “It is not good enough for a public affairs person to say ‘I will get back to you once I have spoken to our expert’.”

He - and those of his colleagues to whom I spoke - said this situation reflects poor preparation for meetings. It is a matter of the resources that firms are prepared to commit to respond to regulatory developments and of the willingness of business experts to go to meetings with officials. On both counts, practice appears to vary between firms. However, even in one Continental firm with a very high reputation for its handling of EU issues, I was told that - although business experts will go to Brussels - they need to be persuaded to do so.

**Seniority**

Where meetings with senior officials do take place, several respondents emphasised the need to be accompanied by an appropriately senior officer of the firm “...as people over there are very status-conscious”.

However, one very experienced participant in European regulatory discussions thought that some firms’ EU regulatory risk/public affairs officers are so clearly respected that senior officials are happy to receive them as speaking on their CEO or Chairman’s behalf. As for the very top people, officials generally seemed to feel that the heads of American firms are more likely to visit Brussels, or to participate in high-level debates (such as those organised by Eurofi) than the British. In contrast, the heads of BNP Paribas and of Deutsche Bank were spontaneously mentioned by MEPs and Commission officials as being particularly engaged in Brussels on a regular basis.
However, the danger of taking chairmen or CEOs to visit Commissioners was stressed by one City person, who remarked on an embarrassing meeting where his chairman clearly had little grasp of the issues under discussion, to the irritation of the Commissioner. But that is not an argument against involving chairmen or CEOs; it simply demonstrates the need for very careful preparation.

In general, the Continental banks that were said by Commission officials to be the most effectively engaged were those whose top people are regular visitors to Brussels. The former head of government relations at one non-City firm stressed the benefits of having someone senior, reporting directly to the CEO, based in Brussels who has the task of building good relations with Members of the Commission and government ministers in key European capitals. Commissioners can learn from industry leaders, and the latter have an opportunity to build relations and raise the profile of their institution.
VIII Persuasiveness

Persuasive presentation of a firm’s case is crucial. “The approach should be constructive in tone, acknowledging or seeking to explore the alleged problem giving rise to a proposal, and constructive in suggesting ways of tackling it.”

Tone

As one very experienced senior official negotiator on policy matters told me, firms’ approach to European officials, should be to ask: “What is it that you want to achieve and let us see how we can help you.”

The global director of regulation at a large firm in an unpopular sector stressed that “you should admit it when you have got something wrong”. The former head of government relations at a large non-City firm also insisted that “the approach should be constructive in tone, acknowledging or seeking to explore the alleged problem giving rise to a proposal, and in suggesting ways of tackling it”. However, several criticisms were made (by officials, MEPs and consultants) of how City firms have behaved - some of which were shared by respondents from the City. In particular:

- Arguing that ‘we did not cause the crisis’ misses the point: “there is enormous pressure on governments and the EU to be seen to be doing something” (Commission official). There is a need on the part of City firms to acknowledge that things went wrong and to be seen as constructive and helpful in suggesting what might be done – and done better or in a more focussed way.

- A firm’s tone can appear arrogant and patronising, treating the audience as stupid. As one City executive said: “The industry did a terrible job” because of this in early submissions on the AIFMD. “I was appalled” (consultant).

- “There is too much of ‘What this means to me’” (City consultant) - and not enough effort to spell out what the proposal means for Europe’s broader economy or society. Several respondents stressed how much better non-financial firms are at doing this.

- “There is too much stress on costs and not enough on the positive aspects of proposals, including the potential benefits for firms, market stability and the wider economy” (senior official; an identical point was made by a consultant on EU issues). As a result, submissions can appear too negative in tone, even where net benefits are possible. “This can mean one is not listened to subsequently.”

Approach must be constructive
Special pleading

Financial firms were criticised for self-serving, special pleading - even when firms in other sectors would suffer as a result of regulations directed at the financial sector. This requires a more focussed effort to get the engagement of such firms and willingness to utilise independent consultants to demonstrate the impact beyond the financial sector.

“Too much comes across as special pleading” was a frequent comment from officials and from people working in or advising City firms. It is a reflection of the difficulty that financial firms have convincing their target audience that measures directed at the financial sector can produce adverse consequences elsewhere in the economy. A number of officials and MEPs contrasted this with the success of other sectors (notably the motor and chemicals industries) in demonstrating the wider threat to jobs and GDP of proposed regulations that are directed at them.

To some degree, this situation suggests inadequate engagement between the financial and “real” sectors.

A notable example was the debate over the original proposal for the Prospectus Directive, which banks claimed would make debt financing more difficult and costly for industrial issuers - an argument that was initially treated as self-serving by Commission officials - while at the same time it was almost impossible to get firms in the “real” economy to take the threat to their capital-raising seriously. More recent examples include the proposals for hedge funds (valued investment vehicles for some pension funds), OTC derivatives (used to hedge commodity price risks by, e.g., manufacturers and airlines) and private equity (useful sources of capital for some innovative firms). As a City regulatory risk director said: “We were too late to engage end users and investors.” In contrast, the European Association of Corporate Treasurers was praised for its effective input into the debate.

Naturally, conflicts of interest do arise between financial and non-financial firms. But even where they share common interests, there appears to be no forum for structured dialogue nor for developing a common strategy to approach the EU institutions about a proposal directed at financial firms that could damage “real” industry.

In contrast, a professional services firm told me that it and some of its peers have twice-yearly meetings with firms in the investment community to discuss regulatory developments of common interest. It emphasised the mutual benefit from this.

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9. Several years ago, I was warned about the intention of the Commission’s environmental officials to include, in a proposed Directive on civil liability for environmental damage, clauses to impose liability on lenders. The US Environmental Protection Agency, the American Bankers Association and US industry bodies warned me that similar US provisions were a major factor in bank collapses and had raised the cost of borrowing for many firms. Via the CBI, where I was Chairman of the Environmental Risk Working Group, and through an informal alliance with some major Continental industrial firms, it became possible to persuade the Commission and enough MEPs to drop the provision because of the threat to jobs and growth unless lenders had operational control of the firm causing environmental damage.
The head of regulatory affairs at a non-City corporate also emphasised the need to engage firms in other sectors who stand to lose significantly as a consequence of regulation aimed at one’s own sector. “But to be taken seriously, they must have skin of their own in the game.”

One problem was pointed out by City people who said that an assessment of the macroeconomic impact of legislation - including potential employment/output/competitiveness/cost implications for the economy at large - is not within the current competence of those who deal with regulatory developments, either at the firm or trade association level. An investment bank’s head of regulatory affairs added:

“Certain other sectors have long been pariahs but, until recently, not us. So they are geared up for doing the macroeconomic analysis to defend their position. It also helps that they have employees and factories scattered over several MEPs’ constituencies.”

The global director of regulatory affairs at a non-City firm added: “We spend a lot of money on the evaluation of regulatory changes - including their macro-economic impact on GDP, prices and employment. For this, we use good professional services firms; their concern for their reputation ensures that their work is rigorous and is taken seriously by the authorities.”

Perhaps it is time for the financial sector to give some thought to whether - and if so how - to remedy this gap in its armoury.

The City is global in scope

The City’s mantra, that “we are global, not simply European”, is taken by many MEPs and Commission officials to reveal an unacceptable degree of dismissiveness in London towards EU ambitions and concerns.

Of course, it is true that much of the business of City firms – including those headquartered in other EU Member States - is global; indeed, the latter tend to do most if not all of their global business in the City rather than back home. Nonetheless, the adverse reaction to the emphasis on the City’s global position needs to be taken seriously. Partly, it might indicate jealousy; but it also reflects lack of understanding of why what firms do in the City is important to European industry, their investors and customers. Overcoming ignorance needs an educational effort, sustained over the long term.

But both jealousy and ignorance raise the question of why major Continental institutions undertaking global business in the City are not more vocal in explaining and defending the role of the City to their fellow citizens and governments. As one official put it: “They cannot keep on sheltering behind the Brits anymore.”

One Continental banker insisted: “The European Parliament is remarkably unaware of the global competitive environment in which we operate - and the threats we face from overseas institutions and places.” This comment, made in private, is unfortunately not one that is often heard in Brussels, Frankfurt, Madrid, Paris or Rome.
IX Other capitals

Persuading governments of a firm's case in capitals around Europe (as well as in Brussels) and monitoring their positions on EU issues is taken seriously by few City firms, although other governments play a decisive role in Council decisions. The approach taken by those few firms (and by some leading non-City firms) needs to become more widespread. Perhaps trade associations and the FCO have a role here.

Most City firms appear not to engage governments or financial authorities in other capitals on EU policy and legislative developments. Nor do they appear to monitor political opinion on EU financial services issues, whether through meetings with politicians or by reviewing speeches and articles. Some told me that their presence is too small (which will be true of some firms in some capitals, but not all). However, one City (non-bank) firm stressed that:

“Country heads are required to visit the ministries and regulators of their country to explain the firm’s position on issues being negotiated in Council. Moreover, high priority is attached by it to targeting the country holding the rotating Presidency.”

Another non-bank made a similar point. One City bank said it is experimenting with using country heads in this way, but that it is too soon to reach a judgement.

The Brussels-based heads of two Continental banks’ representative offices told me that their country heads are expected by the CEO to talk regularly to the authorities of countries where they have a significant presence. One said that, everywhere, “I meet the financial attaches in the permanent representations of the other (EU) countries.”.

One global head of regulatory affairs at a Continental bank emphasised that “it is important to speak with the voice of the country concerned” - an identical point to that made by a senior Commission official. The former said that “an important way in which we do it is via a national bank from the countries we target, with whom we have an informal alliance”. He also emphasised the need to be aware of pronouncements on EU policy by political figures, the authorities and others in European capitals - a point also emphasised by the former head of government relations at a non-City firm. This should embrace speeches and articles by key players and information-formers.

The former head of government relations at a major non-City corporate observed that “an important part of my work was maintaining a close watch on what was happening in other capitals, which I regularly visited and where I focussed on building good relations with governments and regulators”. His point was echoed by the global head of regulatory affairs at another non-City firm, where local businesses were required to monitor developments.

It appears that more firms need to adopt the practice of those (whether in the finance industry or other sectors) that do take developments in other capitals seriously. Perhaps there is a role for the FCO and trade associations here.
X Alliances

Cross-border alliances, perhaps *ad hoc*, can be a very effective way of getting one’s message across (including in other capitals), building relationships and exchanging information. However, very few City financial firms appear to participate in such arrangements - unlike firms to which I spoke in other sectors.

From a City perspective, an alliance with Continental firms can mean that submissions are not so easily dismissed as “the Anglo-Saxons” grumbling again.

I had several experiences of this some years ago. Once was when a number of bank heads in different Member States jointly signed a letter pointing out the disadvantages for consumers of a clause in a particular proposed Directive; on another occasion, they jointly hosted a dinner discussion with key MEPs on a different proposal to explain its adverse economic impact.

One official suggested that City firms should join with Continental peers to consider advising the Systemic Risk Authority (on an informal and confidential basis) of their concerns, should they arise, about market developments.

It was also said by one City firm that an alliance can be particularly effective for firms in different countries whose business models differ from those of firms that dominate their national associations – and, hence, whose interests differ from the positions taken at the level of the European association of national associations. One said it had created a European association of like-minded firms, and another is exploring the possibility. Such associations may have a presence in the public domain, but other, less public, possibilities exist.

The former head of government relations at a dominant firm in a non-City sector emphasised the value of forming alliances with similar Continental firms. Indeed, he had initiated several such alliances. Even though the firms involved had major differences of opinion on several issues, they shared enough common ground for their relationships to be worthwhile. “We produced high quality joint studies on a variety of European issues that were much appreciated by the relevant Commissioner.” The global head of regulatory affairs at another leading non-City firm expressed surprise that few City firms recognise the value of these alliances.

A different kind of “coalition of the willing” involves getting firms in non-financial sectors to speak up to demonstrate that measures ostensibly aimed at financial firms or markets could have damaging consequences for their own businesses.
XI Building relationships

It is clear that a firm’s ability to persuade MEPs and officials of its views depends on having good relations with them - and that means that those representing the firm do not appear only when they want something. Of course, they need to avoid wasting MEPs’ and officials’ time; so they need to have something worthwhile to offer that will help the MEPs’ or officials’ own thinking. A Commission official stressed the need to build good relations with the ESAs and with non-financial participants in the market participant committees.

One large non-City firm emphasised to me the need for a very senior person (such as the chairman or CEO) to be prepared to devote time to building high-level political relations in Europe: “Politicians are populists and welcome suggestions that will go down well with the public and press, so my firm has made a number of suggestions that the former Commissioner responsible for our sector has adopted as his own.” Given the quality of the relationship, the Commissioner also welcomed the regular two hour meetings with the chairmen of the companies that had formed an informal alliance of the leading European firms in his sector - an alliance created to build good relations with the authorities. “After all, our chairmen virtually run the industry in Europe.”

As far as financial services are concerned, the heads of BNP Paribas and Deutsche Bank were frequently referred to in my conversations with MEPs and officials as being particularly effective and politically engaged because of the regular presence of their chairmen and other directors in Brussels.

10. Deutsche Bank was mentioned spontaneously by MEPs and Commission officials in this regard as a bank that gets it right.
XII Conceptual developments

Policy initiatives can emerge from the gestation of ideas discussed in think-tanks in Brussels, in which City firms rarely participate. They are not sufficiently engaged in the 'upstream' evolution of policy and mistakenly believe "We do not do vision".

Policy and legislative proposals do not emerge fully-formed. They are conceived from the visions of policy-oriented think-tanks and academics, politicians, officials, NGOs, and thoughtful people in the industry; they evolve through debate, sometimes over a prolonged period. There are a number of respected think tanks and discussion fora in Brussels, such as Bruegel and CEPS.

One Head of Unit told me how much he values the debates he attends at bodies like these. “I can discuss my own forward thinking and can rely on high-quality responses from those present” - a point echoed by other Commission officials. Participation in such bodies can also be a valuable way of building relationships with officials and picking up warnings of threats.11

However, it is worth noting that the influence on policy of such bodies is open to debate. Most Continental firms seem to feel it is significant, but this was not a universal view.

A common perception among those who participate in think-tank meetings is that such bodies present a platform for exposing ideas in public, and that this can be a useful way of assessing the strength of support for them. Two City-based firms I spoke with agreed on the merits of attendance, but the participation of City-based firms in Brussels think-tank discussions was said by others to be sporadic. “The British are not there, apart from X occasionally”, said one Continental bank participant. Reasons for this appear to be a lack of budget or lack of time or both - reflecting a contrast between the resources committed to EU issues by City firms and those based on the Continent. But it also reflects scepticism in the UK about the value of “intellectualising” and forward-thinking about public policy towards the financial sector. There is a view in the City that “Continents think about building Europe, we don’t”. Another comment was: “Unlike the Continentals, we do not do vision.”

11. A good example was when, a few years ago, attending a high level think-tank in place of my vice chairman, I was quietly warned by an eminent central banker that the City would be denied access to euro liquidity from the ECB via the TARGET system. Officials in London mistakenly rejected the very thought out of hand, but the plan was sprung on them some months later. Forewarned, my own bank had ensured that we had sufficient collateral in place around the euro area to do intra-day repos to acquire euros should the threat materialise.
Both views are mistaken. The first means that firms that are cocooned in a City-orientated mindset are less aware than they should be of ideas that can give rise to policy initiatives. City firms do not get sufficiently involved upstream, especially in policy developments with long gestation periods. The second is simply wrong: the vision of a single financial market in which the City would thrive was very much in Lady Thatcher’s mind when she agreed to qualified majority voting as the basis for the relevant European legislation. And it was Lord Cockfield, as the Commissioner responsible for the single market, who created the concept of mutual recognition as the basis for a single passport for financial firms.

Of course, the outstanding example of the power of ideas is EMU - which also illustrates the effectiveness of joined-up thinking across academia, government and industry in the countries which wanted it most.12

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12. See *Private Sector Involvement in the Euro, The power of ideas*, Stefan Collignon and Daniela Schwartz, Routledge 2003, especially for the role of the Association for the Monetary Union of Europe.
XIII The buy side for firms’ submissions

It is essential, to be effective, to build good relations with those whom firms seek to influence. That means developing a reputation for being constructive and helpful and not contacting officials only when one wants something from them. At the same time, irrespective of the quality of submissions, those on the receiving end must be prepared to give serious thought to the arguments - and that requires open-mindedness and a degree of understanding of what can be quite arcane matters. Also, there are implications for the British presence in the Commission’s services, which needs to be strengthened.

So far, we have been talking about the “sell side” of submissions from firms. But what about the “buy side” of officials and MEPs who receive them?

While one must hope that they are all open-minded, it is also the case that many officials and MEPs come from countries with limited experience of the kinds of financial activity undertaken in the City, which politicians and others loosely, and often derisively, call “Anglo-Saxon” (despite the presence in the UK of institutions from their own countries).

European Parliament

Firms need to do much more to educate MEPs about their sector (including its contribution to Europe’s economy), to engage more MEPs (beyond the Parliament’s Financial Services Forum), and to be prepared to help MEPs. They should not simply ask for things from them.

Several people expressed concern at the lack of expertise on financial issues available to MEPs.

Most MEPS inevitably, have no direct experience of the sector, but they also have little access to objective advice. The Parliament’s secretariat does its best, but with limited resources and expertise/experience of its own. A panel of advisers does exist, but some MEPs (as well as people in firms) thought that its experience is largely academic, and it is ignored by many. In these circumstances, it is not surprising that firms (and some officials) claim that quite a few MEPs take an emotional rather than a dispassionate, evidence-based position on issues. In this respect, they might not be very different from Westminster MPs - but in the UK, and in the Lords, they do tend to benefit from competent advisers to Select Committees.
On top of this, concern was frequently expressed to me about the absence of any moderating and informed opinion within the EPP that would otherwise have existed had the Conservatives not quit the group.

Of course, it is for the European Parliament itself to tackle the issue of professional advice. But there is much more that firms should do to educate MEPs and their assistants (and in this respect the City of London’s briefings for MEPs’ assistants were praised) about how the sector works, its contribution to the European economy, and the implications of proposed legislation.

A regular forum for interaction between firms and MEPs, does exist - the European Parliament Financial Services Forum. However, as one MEP said, “It is a venue for preaching to the converted. Not enough is being done to get to ill-informed MEPs.” That is a challenge for firms to address, perhaps collectively.

The strongly expressed view of one public affairs consultant was that too many firms only see MEPs when they want something from them: “They should recognise the benefit of building good relations with MEPs and being prepared to help them, not only in understanding issues that concern firms but any that are troubling MEPs, including the next speech they have to give.”

The Commission

Suspicion of the Commission’s intentions by firms and Commission officials’ perception of this suspicion both exist. But firms should be more prepared to be proactive in understanding officials’ concerns, helping them to understand the issues and making constructive suggestions before legislation is drafted - not only seeing officials when they want (or oppose) something. The UK government should also do much more to ensure a stronger British presence in the Commission.

Commission officials are under great pressure to respond to political demands to address a wide range of issues associated with the financial crisis. Often, that involves drafting technical legislation about which they know little, with potential consequences they do not always appreciate.

People on this side of the Channel tend to believe that Commission officials think they have a vocation for developing an ever-expanding body of legislation irrespective of their expertise and the facts - a perception vehemently denied by senior Commission officials to whom I spoke. This degree of mutual suspicion might be inevitable, especially following the financial crisis, but it will not be resolved unless firms are prepared to engage with the Commission more proactively - not only when they are attacking it or when they want something. As noted earlier, the aim should be to understand what officials intend and to suggest what (if anything) should be done.
One Continental bank (Deutsche) appears to stand out in its willingness to prepare high-quality, well-researched analyses on a range of topics, going beyond the financial sector, that are appreciated as contributions to long term thinking and which help to build good relations. (Credit Suisse and Goldman Sachs were also remarked upon positively.)

One senior regulatory risk executive in the City stressed: “We need to be seen as helpful, and not as only visiting the Commission when we have something to complain about or to ask. This is part of building good relations and being proactive.” He gave two examples:

- One where, on his own initiative, he took business experts to Brussels to explain the nature of propriety trading to officials shortly after the announcement of the so-called ‘Volcker Rule’.

- Another where his expert colleagues explained the issues surrounding the valuation of complex financial instruments.

Both visits were much appreciated by Commission officials, who had not yet got to grips with understanding either of the issues or any policy implications.

On the other hand, the City was strongly criticised by one official for seldom having been to see the (then) Commissioner prior to the crisis.

There can be little doubt that a shared heritage and/or nationality can oil the wheels of discussion because of certain shared understandings. This in no way implies that officials are necessarily prejudiced against foreigners. But it is a matter of concern among City firms that there are now no British heads of unit in DG Market dealing with financial service/banking matters – and it is at unit level that detailed proposals are prepared. Moreover, there is now no British director in the DG.

This appears to reflect the low priority that Whitehall attaches to getting British nationals into such posts, or appointed as national experts. Moreover, officials who spend time in Brussels, whether in the Commission or UKREP, rarely find that it has enhanced their Whitehall careers; indeed, some claim it has been damaging. Although there are rare exceptions to this, a contrast can be drawn with how other Member States (especially France) regard having nationals in key posts in Brussels. This is something that the Government (and the new UK regulatory bodies) should tackle as a matter of priority - particularly with the new EU-level supervisory authorities. Senior officials acknowledge these issues, but admit it will take time to turn things around.
European Supervisory Authorities

The new ESAs will have the legal power to issue mandatory standards, leaving no room for national discretion. But they are also required to consult. In these circumstances, it is absolutely essential that firms provide the best data and most rigorous analysis, and that they ensure that the best people possible serve on their market participant committees.

The problem is that the ESAs will be staffed by people from all Member States - many of whom have little or no experience of wholesale markets, and some of whom either dislike what they have observed or take a very prescriptive approach to financial regulation. Moreover, the UK will run the risk of being outvoted if its arguments are not well-supported by good evidence from firms. This makes it all the more important that the industry generally raises its game in terms of the quality and persuasiveness of its submissions.
XIV UK government and authorities

A point emphasised by several firms was the lack of a shared strategic vision - among firms, the government and UK officials - about the future of the City and what needs to be done to sustain its success. A contrast can be made with France. HMG is likely to need more expert input from firms – many of which are concerned that the UK’s supervisory changes (and staff cuts at the Treasury) will weaken its engagement with the EU. Given the need to monitor thinking in other capitals, it is worth considering whether there is a role for the FCO in this.

There have been various high level committees of Ministers, officials and senior City figures in recent years. But some of those most familiar with them said they rarely, if ever, came to grips with serious strategic City-wide issues, and that there was little in the way of leadership, strategy, deliverables or action that emerged. The contrast with France was remarked on. Some suggested that the entire culture and web of elite relationships in France makes a cohesive approach easier. Moreover, France has de Larosière.

Firms and officials acknowledge that British officials need rigorous advice from the City on proposals under negotiation in Brussels if they are to be able to persuade their counterparts from other countries. However:

- such advice is not always forthcoming in time and with sufficient high-quality, fact-based evidence; and
- in view of the staff cuts in HM Treasury, there will be an even greater need for support from firms, especially given the role of the ESAs.

Both points need to be taken seriously. The reorganisation of the UK’s supervisory arrangements was said by several City firms to hold risks for the UK through potential dilution of:

- the authorities’ ability to make available sufficient resources devoted to Brussels negotiations; and
- the continuity of expertise of and familiarity with the EU institutions, the negotiating process and the issues.

Quite separately, given the need to monitor thinking in other capitals (see earlier discussion), it is worth considering whether there is also a role for the FCO in this. Its financial attaches in embassies around the EU, with suitable training, might have the potential to make a useful contribution.
XV Effectiveness and proactivity

‘Effectiveness’ means being willing to change policy, whether reacting to an official proposal or proactively initiating one. “Many firms and others mistake access for effectiveness.” Firms should examine ways of evaluating effectiveness. They are generally not proactive either in initiating new policies or planning for potential threats.

Effectiveness also implies persuading policy-makers and legislators to adopt a course of action that would not otherwise have been adopted. This can happen by:

- influencing the development of a policy during its pre-legislative gestation period
- persuading legislators to amend a legislative proposal; or
- persuading them to adopt a proposal that the firm (or firms) initiated.

The first two types of effectiveness are \textit{reactive}, the third is \textit{proactive}. They do not mean holding meetings or making written submissions: they are inputs not output, means not ends.

Reactive effectiveness

Those City firms whom I interviewed, with one exception, admitted that they are not very proactive. As we have seen, some City firms appear to marshal reactive submissions that are well regarded by the official “buy side”. But, with only one exception, none appears to have a system in place for considering the effectiveness of those submissions.

The focus generally appears to be on the number of meetings held with officials or MEPs, and on the papers submitted. As one senior official put it: “They mistake access for effectiveness.” True, it can be difficult to evaluate effectiveness, but it is not always impossible. Firms tend to be very sceptical about the feasibility of evaluating effectiveness: but the main issue is that it has not been attempted. That is a mistake. A better approach might be:

- to specify in advance exactly what changes to policy/legislation are sought and by when;
- to define the means to be used - including written submissions, meetings with officials/MEPs and who is to do what (including collective action via an alliance or trade association) - and the timetable;
to review the outcome and compare it with what was sought; and

• to assess what went right and what was unsuccessful to see what lessons can be learned (such as the realism of goals, the timing, the political dynamics and strength of opposing forces, adequacy of evidence and analysis, strengths/weaknesses of collective action, quality of written presentation, appropriateness of representation at meetings, and so on).

Ideally, this audit should be carried out by someone other than those who performed the action or set the task. In view of the accusations of over-lobbying and the explosion of lobbying efforts by firms and other bodies, ex-post evaluation of performance might lead to more effective and efficient deployment of resources.

Proactive effectiveness

As quoted earlier, one experienced observer pointed out to me that “the City is Europe’s largest financial centre, but you are always reacting to an agenda set by others”. Almost all firms confessed to not being sufficiently proactive.

Proactivity has a number of dimensions - including engaging with policy-makers and legislators as soon as a firm spots something that might concern it. It can also mean engaging with officials and legislators to persuade them to adopt a particular policy or legislative proposal.

Some of those to whom I spoke thought proactivity can be dangerous: “It might give them ideas.” Equally, there were cynics: “Even if what we were to suggest made sense, they will use it as a peg for something we don’t want.”

A (very) few took a different line, seeing proactivity as an essential element in timely engagement and in building good relations with officials and MEPs. One gave the example of initiating meetings between officials and the firm’s technical experts on issues that officials were only just beginning to grasp. However, being proactive in the sense of pressing for a new policy or legislative proposal appears to be rare among City firms.

A good example of proactivity is Paris Europlace’s submission to Commissioner Barnier of its manifesto, EUROPE 2015 - New ambitious measures for an integrated and competitive financial Europe. This was dated September 2010, but was submitted several months earlier. It contains a broad, French, vision, together with detailed policy proposals. Time will tell as to its effectiveness, but it is certainly an example of proactivity on the part of the French.
Two examples where proactivity was actually helpful were given to me by a Commission official. One was Credit Suisse’s proposal for a bondholders’ ‘Bail-in’ when a financial institution faces failure; the other was Goldman Sachs’s conference about the corporate governance of banks, particularly the calibration of risk. Both have been followed up by policy-makers. Some officials suggested that City firms might make a useful contribution to the debate on ‘too big to fail’. Another suggestion concerned an alliance to advise the Systemic Risk Authority.

Strategy for defence against threats

A different type of proactivity involves developing a strategic plan for dealing with potential threats. In the wake of the recent crisis, this would have involved examining where regulatory challenges could be expected to arise, bearing in mind Continental Europe’s assertion that the City’s light regulatory touch was an important element in its success.

This kind of proactivity would have included trying to dispel misunderstandings about the benefits for Europe of the financial markets and operations of the City, such as OTC derivatives, as well as quantifying the volume of business done and the economic contribution of that business. Given the clash of philosophies and competition between financial centres, an attack on the City was always likely once an opportunity arose. As noted, one eminent City figure told me, “the crisis has given them a once-in-a-lifetime opportunity”. Unfortunately, instead of proactivity, we have had (as one Brussels-based consultant put it) “fire-fighting rather than forethought”.

Pro-active threat planning
XVI Centralised supervision

A trend towards centralisation of regulation and supervision is now apparent, through the use of Regulations not Treaty changes. City institutions were late to appreciate the possibility of centralisation, they did not take it seriously, they did not engage with the intellectual case for it, and they did not produce enough analysis of which policy issues matter and how to secure their preferred outcome.

Dangers of centralisation

Some firms instinctively favour centralisation because it should reduce compliance costs. But many of those firms do not seem to have addressed the question of whether it could have adverse implications for the attractiveness of the City and Europe as places to do business.

In my view, City firms should stress the principles upon which supervision should be based, whatever its architecture, perhaps in alliance with Continental institutions.

The issue of supervisory centralisation illustrates many of the issues commented upon earlier, regarding:

- the alternative philosophies of supervision and regulation;
- the need for an early warning mechanism;
- the desirability of a close relationship with policy-makers;
- the need for an understanding of the legislative processes and options;
- the importance of engagement with the conceptual debate; and
- the need to have a clear understanding of the business implications and of the position to take.

At present, those firms that have taken a positive position on centralisation admit to simply hoping for a combination of a benign regulatory philosophy, skilled regulatory and supervisory staff, and congenial operational practices. “A high-risk strategy” – as one investment bank director of regulatory risk admitted to me.
How did this come about?

First, the real possibility of centralisation was not taken seriously by the City until the deliberations of the de Larosière Committee were underway – or even until after publication of its report recommending the creation of European Supervisory Authorities. However, centralisation had long been an objective of some Continental European authorities, especially the French.13 Their aim was (presumably) not one of institutional reorganisation for its own sake, but to impose a particular supervisory philosophy – one very different from that in which the City had thrived. In addition, there was, perhaps, a preference for federalist solutions in principle, and a belief that this approach would give Europe more clout in global negotiations.

For whatever reasons, City firms, individually or collectively, did not engage with the rationale for centralisation as expounded by such people as Tommaso Padoa-Schioppa or Dirk Schoenmaker. The latter, in a closely reasoned paper, argued:

- that financial stability, national supervision and a single market with freedom of capital movements were not simultaneously feasible;
- that supervisory cooperation could break down in a crisis; and
- that the lead supervisor model failed to take sufficient account of host country concerns.

Some of that reasoning is present in the de Larosière report, but firms did not begin to respond until de Larosière was en route to his predictable conclusions. Why were they so slow to cotton on?

One reason is that it had long been taken for granted that centralised banking supervision would require an EU taxpayer-funded budgetary facility for lender of last resort purposes, and that was not on the table. However, the ECB’s willingness to accept eurozone government bonds at par and creation of an EU stabilisation fund have weakened that argument; any EU tax on banks would destroy it.

The possibility of alternative legal bases for supervisory centralisation were not debated by City firms until very recently, if at all. Firms simply assumed that a Treaty change would be needed, and that this would be subject to a UK veto. But this was never the only option for centralisation. An alternative approach was creation of an agency on the basis of a Regulation – as has been contemplated earlier for an EU telecommunications supervisory agency. The fact that EU Member States had

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13. In late 2000, a senior Tresor official said to me that, having achieved its aim of deposing the Bundesbank’s monetary hegemony through the creation of a European Central Bank, the next key objective was European supervision of banking and financial markets. A few weeks later, the financial attaché at the French Permanent Representation pointed out that a single market needed a single supervisor and uniform regulations.
subsequently rejected the Commission’s proposal for a telecoms agency did not undermine the legal argument.

Unfortunately, most of those in the City who were warned of this possible approach dismissed it. Now, we discover that it is on the basis of Regulations that the European Supervisory Authorities are now being created.

On top of that, the Regulation on credit rating agencies – which gives ESMA supervisory powers and which has now been adopted - is the first instance of centralisation at an EU level of supervision over individual firms. It is soon to be followed by supervision of CCPs, if the proposed OTC Regulation is not amended.

If this approach is deemed to be working by a sufficient number of Member States, it is likely that, sooner or later, the same model will be proposed for banking, financial markets and insurance.

The proposed OTC Regulation would also end the current home/host division of powers and would confer decision-making powers on Colleges, with ESMA having the authority to impose decisions when members of the College disagree. In short, whereas Colleges were previously regarded only as fora for discussion and for co-ordinating individual supervisory decisions, the new model is one in which the College itself becomes the decision-taking agency.

It could be argued that City firms, individually and collectively, have been sleepwalking. But what is their position now on this crucial issue?

Some of those to whom I spoke remain opposed to centralisation, others were cautious and some actively wanted centralisation. Those in favour emphasised the potential for cheaper, more efficient compliance if they had to deal with only one, rather than up to 27, national authorities. But had they thought this position through? I asked them whether they understood that centralised EU supervisors might:

- share an unwelcome Continental philosophy with regard to risk, competition, competitiveness, innovation and regulatory prescription rather than permission;
- lack expertise in markets, operations and products that are rarely encountered in many of the Member States from which staff will be drawn; and/or
- share an unpalatable “box-ticking” operational approach

The response from enthusiasts to whom I spoke was that “it is a risk, but the ESAs must be staffed by the FSA or others with similar skills” (as the global head of risk at one bank put it). This was a view repeated by someone with a comparable role in another bank and by two insurance executives. Unfortunately, as officials pointed out
to me, there could well be a significant gap in salaries between Commission scales, on which ESA salaries will be based, and those payable to highly-skilled staff in the FSA and other national supervisors – which will make recruitment of experienced staff a problem. As for the issues above other than staffing, they seem to have been ignored altogether by enthusiasts for centralisation.

It should also be noted that, although lip service is paid (in the Recitals for the Regulations) to the need for the ESAs to take account of innovation and competition, this is absent from the ESAs’ objectives in the relevant Article 1 (which is legally more potent than the Recitals).

It is not possible to divide the pros and the cautious/antis on the issue of centralisation into national categories: both camps include British and American firms. However, a distinction can be drawn between those who operate largely within the UK, who tend to oppose centralisation, and those operating in several countries, among which supporters are found (although some are sceptical).

Collectively, City firms have difficulty speaking with one voice because of the differences in their positions. However, it does not follow that just because large firms disagree, there is no aggregate effect on the City in terms of GDP, jobs or exports. Both sides of the argument over centralization are unlikely to be right.

This does not mean that firms have nothing useful to say. There is an opportunity for them to emphasise that, whatever supervisory structure emerges, it should be permissive rather than prescriptive, risk-based, focussed on outcomes and proportionate. It should also not duplicate responsibilities at national and EU level, it should be based on evidence, and it should have an unambiguous legal foundation. It must also permit supervisory judgement to be exercised. Beyond that, it must be globally engaged, have credible deterrents, and support competition within the EU. It should also promote EU global competitiveness. Such principles should attract the support of even Continental institutions.
XVII Best practice

On the basis of the interviews I have undertaken, I believe one can describe best practice (in terms of interaction with Brussels) as involving:

- early, upstream engagement;
- rigorous business impact analysis;
- clear disciplined positions;
- prioritisation of issues on which to expend political capital;
- a persuasive, constructive tone in presenting a firm’s case;
- the involvement of business experts in meetings with officials and MEPs where technical issues arise;
- assessment of the political position in other members of the Council of Ministers and representation of the firm’s position in other capitals;
- participation in alliances with like-minded firms in other Member States on particular issues;
- engagement with firms in other sectors, with end-users and with investors;
- involvement by a firm’s Chairman/CEO in building relationships;
- proactive assistance to MEPs and officials to help them understand technical issues of potential concern; and
- early involvement in the forward policy agenda.
XVIII Conclusions

I believe that City firms need to raise their game to the best practice of their peers and non-City firms by:

- earlier engagement with the European legislative process, better quality submissions and more effective representation;

- upgrading the skill-set devoted to EU issues to embrace public affairs/government relations staff, business experts and those familiar with authorities in other capitals;

- developing a formal, CEO-driven process to ensure that businesses respond in a timely and rigorous manner to major regulatory developments, and that their heads are held to account for their performance on significant regulatory issues;

- improving the persuasiveness of firms’ arguments in terms of tone (avoiding seemingly self-serving pleading), while engaging end-users and other interested parties earlier, and using external economic or other professional consultants;

- engaging with authorities in other capitals;

- developing alliances with Continental firms on issues of common concern;

- putting more resources into providing data and high quality input for the UK authorities; and

- recognising the benefits of being proactive: if you aren’t, someone else will fill the vacuum!

In particular, City firms should stress the principles upon which supervision should be based, whatever its architecture - perhaps in alliance with Continental institutions.

City firms should also consider ways in which the effectiveness of their involvement with Europe can be evaluated.

Some of this might well involve collective action.

For their part, the UK authorities should ensure that the UK is better represented in key Commission positions, and should give better recognition to staff serving in Brussels (whether in the Commission or UKREP) than has generally been the case.
Breakdown of interviewees for this paper:

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<td>Academia/think tanks</td>
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Malcolm Levitt has been involved in European policy issues for over 30 years. At the European Commission in the late 1970s, he supervised the work that demonstrated that the UK would become the largest net contributor to the Community budget – the basis for the negotiations on the UK rebate. Later as a partner at Ernst & Young he led cross-border studies for the European Commission, advised British and overseas private sector clients on European business opportunities, and led the study that persuaded the Commission to propose a single currency for EMU rather than the alternative in the Delors Report of a common currency, while being personally agnostic about the merits of EMU.

Next, as a senior executive at Barclays he advised on the business implications of EU policy/regulatory developments for retail, corporate and investment banking, treasury management, capital requirements and risk management; he supervised studies for British Invisibles on impediments to market access in Europe, chaired the working group of Commission and central bank officials, bankers and corporate treasurers that planned the practical implementation of the euro – the phased introduction of which was based on his advice, and jointly chaired the Oxford University European Studies Institute staff/postgraduate seminars on EMU. He also developed plans for Barclays’ governance of regulatory/public policy issues for the Chairman and CEO, and was an expert adviser to the House of Lords Europe Committee.

Since retiring from full time work, he has been: an adviser on to the City of London (he chaired the City EU Regulatory Working group), an adviser to PWC (then IBM Consulting), and a non-executive director at Houston Consulting Europe (now Kreab Gavin Anderson): currently, he is the adviser on financial services to Reguleyes.

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