

CSFI

CENTRE FOR THE STUDY OF FINANCIAL INNOVATION

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To: Members of the CSFI Advisory Council

From: Andrew Hilton

Date: Aug 2, 2004

Advisory Council Meeting: July 21, 2004

A meeting of the CSFI's Advisory Council was held on the evening of July 21; in the absence of John Plender, this was chaired by David Lascelles. A list of those attending is given as Appendix I and an agenda is given as Appendix II.

The intention of Advisory Council meetings is both to give structure to the Centre's work programme and to have a good discussion on key issues at the same time. These notes concentrate on the former – identifying the particular topics that Council members felt we should pursue. I have also included suggestions that were e-mailed to us by those who couldn't attend. Please note that we would be very grateful for help with speakers and writers (not to mention help with venues and/or sponsorship of individual round-tables or reports).

1 Pensions/savings: In my opinion, this is likely to be the most important economic, political and social issue in the UK over the next few years – and it is an issue that is rapidly gaining traction in the US and in Continental Europe as well. It is also an area in which we have already done a great deal of work (a list of pensions-related round-tables and reports is given as Appendix III) – but with virtually no follow-up. The primary need is to find someone who could pull the work we have already done into some sort of more-or-less definitive CSFI position. Neither David nor I has the time, but I (at least) do have the interest, and would work with anyone who wanted to use our material.¹

Even though we have looked at the pensions and savings issue from a number of angles, there is still a lot more to do. The following topics were raised at the meeting (in no particular order):

- The local authority issue: Graham Bishop, in particular, characterised this as “close to explosion”. Waltham Forest is an egregious example. (Need to find academics or journalists covering this.)

¹ John Godfrey very kindly offered some help – an offer which I will make sure he regrets.

- Can pensions be “depoliticised”? This is my own hobby-horse. I do not believe (*pace* Willetts) that the pension question is any more inherently a “political” issue than monetary policy; if we can depoliticise one, why not the other?
- The annuitisation issue: There are two separable topics here. One is Oonagh McDonald’s campaign to end compulsory annuitisation (or to delay it, or to offer alternative ways of ensuring income in old age). The other (which interests me more) is to look at the structure of the annuity market itself. Why are there only two providers of bulk annuities, and a shrinking number of individual annuity providers? How competitive is the industry? How keenly are they priced? We need to identify analysts/journalists covering the annuity market – as well as buyers (Law Debenture for bulk annuities?).
- The role of pension fund trustees: What is their legal liability – particularly post-WH Smith/M&S? Could we get Martin Taylor to speak (he spoke at a r/t when he was still at Barclays)? Maybe David Lascelles could call him. Related issue: Are pension fund deficits a 21st century poison pill? If so, should the authorities intervene on those grounds alone. (Paul Richards passed on the name of David Heyton, King’s College, London, as a potential speaker on trustee liability.)
- Pensions simplification: Personally, I am much attracted to the idea that, since there is no evidence that tax incentives increase the overall amount of savings (though they shift savings around), we should abolish all tax incentives to save, and use the increased tax revenues (around £15 billion a year) to boost the basic state pension to something anyone could live on with dignity. Does anyone who can handle the numbers feel like writing this up as a CSFI paper?
- International comparisons: William MacDougall suggested that we should look at work being done elsewhere – particularly to keep the cost of investment products down. Germany and Chile are interesting. John Llewellyn, at Lehman Brothers, is said to have done interesting work on comparative pension sustainability. (There is a linked question: What is it about the specific UK market that makes it so difficult, or if one believes the industry, impossible, to offer 1% fee products? Would a longer lock-in provision drive down the cost, or is there some other issue?)
- Equity release products: It is very clear that people have been pouring savings in to their houses – but it is equally clear that there is no good way of getting those savings, out short of an outright sale. This is an old chestnut. But is there any way to design an equity release product that is less dire than the ones that have hit the market so far?
- Means-testing: There was widespread – and non-ideological – support at the meeting for the idea that means-testing for benefits should be abolished. It is expensive, inefficient and it has serious adverse unintended consequences. Anyone interested in helping with a paper or a round-table specifically on this?
- The Pension Protection Fund: There was a great deal of scepticism about the PPF. How can it avoid moral hazard? What is it going to invest in?

There are also a number of studies just out or about to come out that would be worth a round-table. These include:

- the paper from the CBI by Richard Greenhalgh *et al*;
- the TUC’s pensions paper;

- the Treasury paper from Peter Davis *et al*; and
- the recent ABI paper on why young people won't save.

More specifically on the savings side, it was also agreed that we should look at:

- the personal bankruptcy regime (Charles Goodhart expressed the fear that increasing recourse to an easier personal bankruptcy regime by students could undermine university funding in the UK);
- doorstep lending (it is hard to get the main players to talk, but “impaired lending” is one of the fastest growing areas in financial services, and clearly meets a need; we should approach it with an open mind); and
- risk warnings (we need to build on the dinner we held at the Pru on “visualising risk”).

2 **Regulation:** There was a strong feeling that the Centre's focus ought to be on the downside of regulation – specifically the cost of regulation.¹ The CPS has work going on in this area, but it may be a bit political (press reports suggest it was “commissioned” by the Conservatives, though that appears to be a misunderstanding). This focus is consistent with the Gershon review. The Corporation has also just produced a report on reducing the regulatory burden, on which we would like to hold a round-table. Can we see a way to cut the cost of regulation without weakening the content (perhaps by eliminating duplicate filings)? If the CPS work doesn't address this, we must do something.

Anecdotally, MacDougall suggested that the high relative cost of regulation is starting to drive financial firms out of London (to Paris, Amsterdam, Dublin). We need someone to carry out some survey research on our behalf to see if this is true.

Other issues in the regulatory area:

- Basel 2: There is still mileage in this – particularly (I think) differential implementation in the US and Europe. Goodhart emphasised the home/host issue. There is also the broader issue of whether Basel makes any difference at all, given that all big European banks operate with far more than 8% capital, and that all US banks are subject to the leverage ratio. (And if, as many claim, it doesn't make any difference, why is everyone so exercised about it?) Andy Fishman suggested that we look at validation of credit ratings.
- Regulatory arbitrage: David Green was impressed by the fact that banks don't seem to want identical regulation in the countries in which they operate. Why not? Linked to this, he noted that – with the admission of 10 new member states – it is now fairly commonplace in Europe that a country's banking sector is dominated by non-national institutions. If something goes wrong, who pays?

¹ It is said that HSBC now has more than 400 global regulatory masters. Much of the reporting that is required is duplicative and is repetitious.

- FSAP: Alan Brener suggested that we approach Theresa Villiers, before she leaves Brussels, to speak to us on her experience of decision-making in the EU. (Thought: could we do this as a sponsored dinner?)
- Insurance regulation: David Lawton suggested we look at the attempt to develop a “Basel look-alike” in this area. (By coincidence, we now have a draft paper on insurance legislation by Shirley Beglinger.)
- Constitution: What should we do about the EU Constitution? It is too late to affect what goes into it, but there may still be an educational value in combing through it for its impact on the City. Geoffrey Fitchew – while provisionally agreeing to anchor another meeting (perhaps with Malcolm Levitt) – wondered if/when the Government will issue a White Paper on the Constitution. It was also noted that the draft text still needs to be “tidied up”. (Richards suggested Mannheim’s Prof. Roland Vaubel as a speaker on the Constitution and financial services – if we can get him over.)

3 Clearing & settlement: This is another area that is ripe for a revisit. Shaun Curtis noted that the Corporation has just published a study (by NERA), which could be the basis for a round-table *tour d’horizon*. Happy to oblige.

It was emphasised (by Keith Gold, among others) that we need to look beyond securities to include money. Potential speakers mentioned included Chris Pearson (outgoing ceo of APACS), Marion King (BACS), Baron Frankel (ECB), Tim Jones (Simpay).

Chirs Clegg also suggested we revisit the Paypal model – “cheap, immediate, this is what the banks should do...”

Goodhart suggested we look at the changes to the UK money markets – the biggest in 25 years. Perhaps the BofE’s Paul Tucker would speak.

4 Stock markets: One obvious gap was pointed out by Lascelles: we haven’t had anyone from the Stock Exchange recently to talk about its strategy. Could this be another (sponsored) dinner? (This is particularly appropriate since we are also trying to finalise a round-table with Jean-Francois Theodore of Euronext.)

If we get someone from the LSE, Jonathan Barber pointed out, we should also get someone from AIM. Probably also NASDAQ, which is now trying to get 20% of its listings from outside the US.

A more philosophical topic for debate would be the possibilities for “listing arbitrage” (MacDougall). Is this (or will it be) a real problem?

There are also the usual European issues – notably the Prospectus Directive and the Market Abuse Directive.

5 Emerging markets: On Islamic banking (on which we hope to schedule a round-table shortly), Goodhart suggested we contact John Presley, professor of economics at Loughborough.

I also wittered away about changing the entire model of development aid from a “top down” model (Bank/Fund etc), which no matter how efficient will always be remote from the actual development spend, to “bottom up” (based on the microfinance model). Again, it would be great to find someone interested enough to do work on this.

Other issues:

- Hawala: Keith Haarhoff pressed us to look again at this – which we are doing (a round-table is being set up with a team from East Anglia, and an ex-staffer at the IMF has promised us a paper).
- Copenhagen consensus: Richard Farrant suggested we identify someone who has been involved with *The Economist*'s initiative in this area – an attempt to blue-sky where radical economics is going.
- Opportunities for financial services in the new EU member states: We may be able to get the ERRD's Willem Buiters to come and talk on this after the Bank's next *Transition Report* has been published.

6 Technology: Angus Hislop suggested we need to look again at the issues raised by security technology – notably radio frequency ID, tags on credit cards, the pervasiveness of telephone conversation recording etc. Is the loss of privacy a real problem? (It was noted that when, in the US, Wal-Mart tried RFID, there were “mini-riots”; but maybe the Brits are more passive.) John Bullard extended this into identity theft, and suggested Andy Ross of RBS's Trust Assured as a speaker.

7 Other issues: One of the issues that came up (Barber; Lascelles) was the Operating and Financial Review, due imminently. The guidance to directors will be exceptionally important, and we must cover it. Plus, will the OFR lead the demands for a US-style SEC in the UK, with massive enforcement power?

Risk is also a big (and separate) issue. I mentioned the very strong turnout to hear UCL's John Adams (whose work has been in geography and urban planning). Maybe we ought to look at military approaches to risk.

David Creed also suggested a look at attempts (led by GE Capital) to standardise bank charges.

Comments on any or all of the above – with thoughts for speakers, writers or sponsors – gratefully received.

**Meeting of the CSFI's Advisory Council: Held on July 21, 2004,
at the City Club (Garden Room), 19 Old Broad Street, London, EC2N 1DS
from 6:00-8:15pm.**

CSFI

David Lascelles
Andrew Hilton
Rhiannon Davidge

Co-Director, Acting Chairman, Advisory Council
Director

Members

Caroline Banzky
Alan Brener
Chris Clegg
Shaun Curtis
Richard Farrant
Neil Fatharly
Charles Goodhart
David Green
Guy Hewitt
David Lawton
William MacDougall
Keith Middlemass
Stephen Norton
David Potter
Paul Richards
John Rushton
Paul Symons

Law Debenture
Royal Bank of Scotland
Abbey
Corporation of London
Banking Code Standards Board
KPMG
LSE/CSFI Governing Council
FSA
Standard & Poor's
HM Treasury

Accenture
Law Debenture
CSFI Governing Council
Bank of England
PA Consulting
CrestCo/Euroclear

Guests

Jonathan Barber
Graham Bishop
John Bullard
Brandon Davies
Geoffrey Fitchew
John Godfrey
Keith Gold
Keith Haarhoff
Angus Hislop
Con Keating
Timothy Spangler

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Advisory Council, July 21, 2004,
Agenda

The general areas for future CSFI round-tables that we would like to cover at this meeting are:

- pensions (how can we make a contribution?)
- the savings issue more broadly (Sandler *et al.*)
- emerging markets;
- regulation (Basel, CAD3, Insurance Mediation Directive etc, plus a “scorecard” for the FSA);
- clearing & settlement;
- stock markets;
- technology;
- insurance (both regulation and capitalisation)
- corporate governance (Sarbox etc); and
- the European Constitution.

We hope that the discussion will be pretty open-ended. You are therefore encouraged to bring your own ideas. (We would also like to solicit your views on fund-raising and staffing issues.)

We have also received a number of suggestions for topics (from *inter alia* Brandon Davies, David Creed, Alexander Evans, Andrew Fishman) which I will bring along and summarise.

CSFI work on Pensions

Round-tables

- 1) Protecting pensions: A round-table discussion on the proposed Pension Protection Fund and related issues, with John Ralfe (John Ralfe Consulting) and Andrew Young (Government Actuary's Department). Held on Monday, May 17, 2004, at the City Club (Garden Room), 19 Old Broad Street, London, EC2N 1DS, from 6:30-8:15pm. (With support from RBC Capital Markets)
- 2) Saving occupational pensions: A round-table discussion on a proposal from the Law Debenture Pension Trust Corporation, with Richard Thomas. Held May 6, 2004 at Wax Chandlers', 6 Gresham Street, London, EC2V 7AD, from 12:30-2:15pm.
- 3) Lurching towards a pensions solution (continued)... A round-table discussion with Peter Lilley MP and Ros Altmann. Held on Tuesday, April 20, 2004, at Wax Chandler's Hall, Gresham Street, London, EC2V 7AD, from 12:30-2:15pm.
- 4) Lurching towards a solution for the pensions problem: A round-table discussion, with David Willetts MP and Christine Farnish (NAPF). Held on April 7, 2004 at Wax Chandlers' Hall, 6 Gresham Street, London, EC2V 7AD, from 12:20-2:15pm.
- 5) The work of the Pension Commission: A round-table discussion with Adair Turner. Held on Tuesday, February 10, 2004 at Wax Chandlers' Hall, 6 Gresham Street, London, EC2V 7AD from 12:30-2:15pm.
- 6) The future of financial advice in a post-polarisation marketplace: a round-table with Stuart Fowler. Held on October 31, 2002, at Clifford Chance, 200 Aldersgate Street, London EC1A 4JJ, from 12:30-2:15pm.
- 7) The future of financial advice in a post-polarisation marketplace: A CSFI working group (supported by Accenture) with Stuart Fowler. Third meeting held at Edward Alfred Room, Accenture, 5th Floor, 16 Queen Victoria Street, EC4N 4TW on Tuesday, July 16, 2002 at 5:30-7:15pm.
- 8) The future of financial advice in a post-polarisation marketplace: A CSFI working group (supported by Accenture) with Stuart Fowler. Second meeting held at Chartered Insurance Institute, 20 Aldermanbury, London EC2V 7HY, on Thursday, June 27, 2002 at 12:30-2:15pm.
- 9) The future of financial advice in a post-polarisation marketplace: A CSFI working group (supported by Accenture) with Stuart Fowler. First meeting held at Wax Chandlers' Hall, Gresham Street, London, EC2V 7AD on Tuesday, June 11, 2002 at 12:30-2:15pm.
- 10) The annuity problem: A round-table discussion on retirement provision, with Sheila McKechnie and Oonagh McDonald. Held at the City Club, 19 Old Broad Street, London, EC2N 1DS from 12:30pm-2:15pm, on Monday, May 27, 2002.

- 11) The changing shape of pension assets: FRS 17 and all that. A round-table discussion with John Ralfe (Boots), Sir John Craven (Lonmin), Graham Bishop (grahambishop.com) and Allan Martin. Held at the Association of British Insurers, 51 Gresham Street, London EC2V 7HQ from 12:30-2:15pm on 1 May, 2002.
- 12) Impact of European pensions reform: A round-table with Graham Bishop (grahambishop.com) and Alan Pickering (Watson Wyatt). Held at Wax Chandlers' Hall, Gresham Street, London EC2V 7AD from 12:30-2:15 on Monday, April 8, 2002.
- 13) The European pensions nightmare: A round-table discussion with Frank Field MP, Richard Surface (Oliver Wyman & Co) and Mark Hayes-Newington (The Research Department). Held at The City Club, 19 Old Broad Street, London, EC2N 1DS on March 12, 2002 from 12:30-2:15pm.
- 14) How pensions reform in Europe will drive the long-term savings industry: A round-table discussion with Chris Gentle and Andrew Power (Deloitte Consulting). Held at Wax Chandlers' Hall, Gresham Street, London EC2V 7AD, from 12:30-2:15pm on Wednesday, January 30, 2002.
- 15) The role of annuities in the provision of retirement income: A round-table discussion with Peter Lilley, MP, Oonagh McDonald, Mike Wadsworth and Laurie Edmans. Held at Wax Chandlers Hall, Gresham Street, London EC2V 7AD on Thursday March 29, 2001, 12:30-2:15pm.
- 16) What chance a European market in pensions? A round-table discussion with Robin Ellison (Eversheds), Dr Ann Robinson (NAPF) and John Hayes (OPRA). Held on June 8, 12:30-2:15pm at the City of London Club, 19 Old Broad Street, London EC2N 1DS.

Publications

Pensions in crisis? Restoring confidence: A note on a conference held on February 26, 2003. May 2003.

"The future of financial advice in a post-polarisation marketplace". By Stuart Fowler. November 2002.

"Waiting for Ariadne: A suggestion for reforming financial services regulation". By Kevin James. July 2002.

"Welfare: A radical rethink – The personal Welfare Plan". By Andrew Dobson. May 1996.