CFA UK is a member society of

The Clerk,
Joint Committee on the draft Financial Services Bill,
House of Lords,
London, SW1A 0PW.

Dear Sir/Madam,

The Chartered Financial Analyst Society of the United Kingdom (CFA UK) welcomes the opportunity to respond to the Joint Committee on the draft Financial Services Bill – call for evidence.

<u>About CFA UK and CFA Institute</u>

The society represents investment professionals in the UK, most of whom work as front office investment professionals (managing portfolios, researching securities and advising on asset management). This response has been prepared by CFA UK's Professional Standards and Market Practices Committee. The society has not surveyed members in relation to this consultation.

The CFA Society of the UK (CFA UK) represents the interests of more than 9,000 leading members of the UK investment profession. The society, which was founded in 1955, is one of the largest member societies of CFA Institute and is committed to leading the development of the investment profession through the promotion of the highest ethical standards and through the provision of continuing education, advocacy, information and career support on behalf of its members. Most CFA UK members have earned the Chartered Financial Analyst® (CFA®) designation, or are candidates registered in CFA Institute's CFA Program. Both members and candidates attest to adhere to CFA Institute's Code of Ethics and Standards of Professional Conduct.

CFA Institute is the global association for investment professionals. It administers the CFA and CIPM curriculum and exam programs worldwide; publishes research; conducts professional development programs; and sets voluntary, ethics-based professional and performance-reporting standards for the investment industry. CFA Institute has more than 100,000 members in 140 countries, of whom more than 90,000 hold the Chartered Financial Analyst (CFA) designation.

<u>Response to the call for evidence</u>

Rationale, observations and context for our evidence

"I made a mistake in presuming that the self-interests of organizations, specifically banks and others….were best capable of protecting their own shareholders and their equity in the firms…….. you know, that's precisely the reason I was shocked, because I have been going for 40 years or more with very considerable evidence that it (free market theory) was working exceptionally well." Alan Greenspan.

CFA UK is of the view that the recent crisis and those before it were caused by financial amnesia and ineffective regulation. The FSA[1] continues to address the crisis in conduct and regulatory failures which occurred during the pre and post-crisis period - events which have been less widely reported but still highlight the extent to which market integrity has been compromised. We remain concerned that the new framework is fighting the last war, that it is overly focused on bank failure and that it will be ill-equipped to deal with the next crisis in the UK financial services industry.

Financial amnesia

Financial amnesia is when financial market participants forget or behave as if they have forgotten the lessons from financial history. Financial market participants are composed of two main groups, regulated financial firms and regulators. Despite the history of bitter experience, the same mistakes occur with alarming regularity (see Appendix 1). The three key lessons that participants appear to forget are:

Lesson 1: "Innovation", the illusion of safety and "this time it's different": "The world of finance hails the invention of the wheel over and over again, often in a slightly more unstable version" (Galbraith).The expansion of credit plays a key role in fuelling "innovation" while the creation of an illusion of safety results in a "this time it's different" approach that enables the continuation of unsustainable activity and risk taking. Sadly, each time it is always the same and never different.

Lesson 2: Regulated financial firms are prone to failure: It has been presumed that regulated financial firms by acting in their own self interest and in the interests of their shareholders, impose market discipline. History has demonstrated that because failure to impose market discipline is not uncommon, over-reliance on market forces can be misleading.

Lesson 3: Ineffective regulation. The frequency of market failure places a greater onus on the regulator to be more effective in encouraging and imposing market discipline. Sadly, regulators focus on the symptoms of failure rather than its root causes. Furthermore, regulators often ignore the root cause of their own inability to act promptly and thereby contribute to the risk of systemic governance failure. The drive to introduce a new framework via the Financial Services Bill is another example of a failure to address root causes by focussing solely on symptoms.

Effective regulation involves the design of policies, rules and laws that are effectively monitored and supported by the credible threat of enforcement. The new framework is focused on new architecture rather than making the existing one work more effectively. The tripartite system failed because insufficient emphasis was placed on supervision and enforcement. In our opinion, the risks of regulatory failure have not been reduced.

CFA UK believes that effective regulation is essential for the laws of demand and supply to function appropriately. History has demonstrated that market discipline cannot be reliably imposed by all regulated financial firms. The high risk of market failure makes the regulator the last line of defence for maintaining market integrity and thereby trust and confidence.

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[1] FSA refers two banks to enforcement over high risk consumers
http://www.moneymarketing.co.uk/regulation/fsa-refers-two-banks-to-enforcement-over-high-risk-customers/1033258.article

Arch cru package does not hide FSA failings
http://www.moneymarketing.co.uk/investments/arch-cru-package-does-not-hide-fsa-failings/1035215.article

Sadly, the evidence demonstrates that the regulator is also prone to failure. CFA UK calls upon regulators to learn from financial and corporate history and to make material changes in their regulatory approach to deliver the following outcomes:

1) Firms conduct themselves to the highest professional and ethical standards and place clients' interests first.

2) Enhance financial capability so that consumers become a more robust source of market discipline on firms.

3) Establish a regulatory philosophy and approach which acknowledges that we live in a world populated by people who do not always act rationally and imperfect markets. Rather than facing a binary choice of market mechanism or command and control, the philosophy should embrace asymmetric paternalism. This would create an environment of market command with robust control mechanisms and make it possible for firms to fail without endangering the system or imposing major costs on the rest of society.

Just like regulated firms, senior regulators should also be held to account. However, along with the senior managers at financial firms that had engaged in inappropriate activity, very few senior regulators have been held to account following the crisis.

As La Porta et al[2] suggest "these laws and the quality of their enforcement by regulators and courts are essential elements of corporate governance and finance… in contrast, when the legal system does not protect outside investors, corporate governance and external finance do not work well." On occasion it may be more beneficial to enforce existing laws and regulations than devise new policies, or as La Porta et al state: "the strategy for reform is not to create an ideal set of rules and then see how well they can be enforced, but rather to enact the rules that can be enforced within the existing structure."

By improving the quality of the regulatory environment, the level of trust and confidence can be raised. The onus will be on each generation of regulators to learn from the mistakes of their predecessors. By fulfilling the essential role they play in enhancing the quality of market integrity, regulators will be able to further strengthen the UK's position as a leading global financial centre.

<u>Below is our opinion as to whether the draft legislation will or could do better.</u>

- prevent another financial crisis

"We can't hope to prevent financial crises from happening, but we can build institutions that help to ensure that our financial system is more resilient in the future." (Mervyn King)[3]

The draft legislation has been based on the premise that the next financial crisis will be similar to the most recent one. The current approach is based on fighting the last war rather than addressing the root causes of the financial crisis, namely a systemic governance failure resulting from financial amnesia and ineffective regulation. Based on our assessment the

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[2] La Porta, Rafael, Lopez de Silanes, Florencio, Shleifer, Andrei and Vishny, Robert W., "Investor Protection and Corporate Governance" (June 1999). Available at SSRN: http://ssrn.com/abstract=183908 or DOI: 10.2139/ssrn.183908

[3] http://www.telegraph.co.uk/finance/economics/8597139/Financial-Policy-Committee-the-key-quotes.html

proposed framework is unlikely to prevent another crisis, but is likely to change the location of the next crisis. The framework itself is a lesser issue, the more important question is whether or not the framework will be implemented effectively to reduce the impact of the next crisis. The UK's regulatory history does not persuade us that it will.

- handle a financial crisis

Based on our view that the proposed legislation fights the last war and the next crisis will be different, the new framework will be exposed again. The new framework demonstrates it has not learned the harsh lessons of financial history and is thereby ready to repeat the same mistakes. Before finalizing the new legislation it would valuable for the government to produce some evidence to demonstrate how the new framework would have delivered a better outcome than the existing tripartite system in the following areas:

1) Reduced the threats to market integrity and trust.
2) Ensured that those responsible would be held to account.
3) The costs to the taxpayer and the wider economy would have been greatly reduced.

The new framework relies on rhetoric to demonstrate that it can handle the next crisis. Neither the UK Government nor the FSA have produced evidence to demonstrate/ show how the proposed architecture would have been more effective in handling the last crisis, let alone the conduct failures that continue to come to light. More evidence is required from the policymakers to demonstrate that the proposed regulatory architecture would have done a better job in addressing the root causes of the financial crisis.

- deal with bank failure and protect the public purse.

The public purse has been left in a precarious condition because of the economic impact of the recent crisis. According to The Economist[4] the impact on the UK economy of the current financial crisis is that Gross Domestic Product (GDP) remains 15% below the level at the end of 2007. To provide a meaningful international comparison, UK's real (taking into account the effects of inflation) GDP per person has declined by 4% since Q4 2007. Based on the list of 28 countries provided by The Economist, the UK has fared fourth worst during the crisis. Only Italy, Greece, and Ireland have performed worse than the UK. Given the consequences of systemic governance failures on the wider economy, the public purse is unlikely to be protected when the next crisis takes place. The public purse will need to be restored to health before it can cope with the next crisis. We have yet to see the full impact of the Eurozone debt crisis - another example of a systemic governance failure.

The legislation may be better placed to address bank failure, although it remains to be seen whether or not the public purse will be insulated. There is insufficient evidence provided by the government and regulators to convince us that the already strained pubic finances will not be called upon again, should another major bank run into major difficulties. There is also little comfort or reassurance that once again, political motives will not interfere with and hinder the orderly failure of a major financial institution without calling upon the taxpayer.

The Joint Committee is also interested in whether the proposals in the draft Bill will increase or decrease the risk or regulatory arbitrage of financial businesses.

[4] "Which economies have fared best and worst during the global financial crisis," The Economist ONLINE, 18 August 2011.

The last crisis highlighted that some major financial institutions were willing to undertake activities that, while in the name of the law were acceptable, proved not to be in the spirit of the law. Some firms will always be willing to take regulatory risks, but what a regulatory framework that is effectively supervised and enforced can ensure is that the costs of engaging in activity to circumvent the rules exceed the benefits derived from those activities. When firms are found to engage in activity that is against the spirit of the regulation, they should be made an example of to those in the industry who are considering similar types of activity. In our view, the ability of the new framework to provide effective regulation is still open to question

.Our comments on your detailed questions are given below

1. Is the separation of prudential and conduct regulation into a "twin peaks" system the right approach?

We now have a variation on the tripartite system and it remains to be seen if it is more effective. The case for the new framework being more effective has not been well supported. With regard to separation of prudential and conduct regulation, this is only the case with banks, insurance companies and some investment firms. The FCA will be responsible for prudential and conduct regulation for 24,000 firms.

The focus on bank failure also highlights that the key issue of systemic governance failure is being overlooked. As has been demonstrated by the recent and previous crises, firms failed because of a breakdown in governance, which demonstrates that prudential supervision is in itself intertwined with conduct regulation. As Paul Moore (former senior risk manager at Halifax Bank of Scotland) stated in a television interview[5] - "I realised the bank was moving too fast and I raised those challenges very strongly at board level. I also raised issues of cultural indisposition to challenge and inappropriate behaviours, and ultimately I was sacked.... I raised and reported all of this whistle-blowing claim that I had with the FSA but they did nothing either."

The separation creates a potential risk of gaps developing, as they did in the tripartite regime.

2. What lessons can be learnt from the approach of other countries to the regulation of the financial sector?

The key lessons the UK needs to learn are that regulators should make it clear that they will not tolerate firms behaving in any inappropriate manner that undermines market integrity or engages in activities that result in significant consumer detriment. Furthermore, firms should be in no doubt that the costs of inappropriate behaviour will significantly exceed any benefits from such behaviour.

What we can learn from other countries is that an effective regulatory environment is a public good. We can learn (from other countries) that the regulator needs to have courage and the will to act decisively. Also, that the regulator is able to make an example of firms, even large ones, when they act against their clients' interests or compromise market integrity. We should learn why some national banking systems did not suffer as greatly as the UK's and understand the structural reasons for these positive outcomes, especially in terms of cost to the tax payer and the wider economy. In addition, for non-bank financial firms we should also

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[5] http://news.bbc.co.uk/1/hi/uk_politics/7882119.stm

be aware of how non-UK regulators address firms that act inappropriately. In Japan for example, large firms can have their right to conduct financial business revoked on a temporary basis. This demonstrates that fines, however large on a headline basis, may be insufficient as a deterrent to firms considering inappropriate behaviour.

3. Is it appropriate to make such major changes to the regulatory system by way of amending legislation, rather than starting afresh?

As we have cited above, the most effective way forward would have been to supervise and enforce existing requirements more effectively rather than rearrange the current tripartite system. Instead of fixing a bolt on the stable door, the proposals are knocking down the existing stable and building a new one, which based on our assessment, still has no effective bolt on it.

4. Are the accountability and governance arrangements for the Bank of England, FPC, PRA and FCA satisfactory?

History has demonstrated that senior regulators are rarely held to account. They were not held to account for the regulatory failure during the pre-tripartite era nor has anyone been yet held to account for the failure of the tripartite system. The new framework will be staffed by many of the key personnel that were in post in the period prior to the recent crisis.

5. Are the FPC's objectives the right ones? Is the concept of financial stability adequately understood for the FPC to be able to perform against its objectives?

"We can do a lot better job than in the past… There were warnings, from this institution (Bank of England), some from the FSA, many from abroad, and yet no one picked up the warnings and ran with them." (Paul Tucker)[6]

The quote from Paul Tucker demonstrates that the success of the FPC as well as the new framework will be determined by how effectively the FPC's recommendations are put into action in a timely manner.

6 Should the FPC be limited in the actions it can take which might affect the growth of the financial sector?

The aim should be to ensure that rather than growth at any cost, it is the quality of the financial sector that is protected. The regulator's mandate should be to ensure that the UK financial sector is of the highest quality possible. Firms that wish to conduct business here can signal their quality by being able to demonstrate that they adhere to the highest professionals and ethical standards and place their clients' interests above their own.

7. How will the interaction between macro-prudential and monetary policies be handled by the FPC and the MPC?

No comment

[6] http://www.bbc.co.uk/news/business-13782849

8. Has the right balance been struck between the powers of the FPC and the powers of the Treasury?

Not entirely as there is still the risk that the political drivers at the Treasury may influence the FPC. The UK Government has not provided sufficient evidence to show that the FPC will not be unduly influenced.

9. Can Parliament take an informed decision about the proposals for the FPC without details of the macro-prudential tools at its disposal?

As stated above, Parliament will have a difficult challenge to assess the FPC without the information and evidence to support how the FPC will meet its objectives.

10. Does the draft Bill adequately deal with the risks posed by the shadow banking system?

This question demonstrates that there is an overemphasis on symptoms rather than root causes. The shadow banking system[7] demonstrated one of the unintended consequences of the financial industry that regulators were not fully aware of (and if they were, they had not appreciated the implications of its existence). The shadow banking system was not harmful in itself, as it offered many valuable aspects not available in traditional banking; these were not driven by regulatory arbitrage. However, it was how the system was used that proved to be so costly. The shadow banking system was primarily driven by regulatory capital arbitrage. If the new regulatory framework is looking for risks from the shadow banking sector it may overlook those posed by other means used to conduct regulatory arbitrage. The PRA will need to be up to the job of spotting and assessing the inappropriate aspects of the next version of the "shadow banking" system.

11. Are the PRA's objectives clear and appropriate?

Yes, although the PRA is a response to the symptoms of the last crisis. There is little evidence provided by the government to show how the PRA would have made a significant difference in identifying the activities that resulted in the recent crisis.

12. Are there any risks in the Government's proposed 'judgement-based' regulation?

There are always risks in any judgement-based approach, especially the risk of getting it wrong. However, the key factor to consider is whether the people making those judgments have the appropriate skills, expertise and have the information to make the appropriate assessments. Even more important is whether these same people have the willingness and ability to act decisively. Based on the inability of the key regulatory personnel to identify and act to counter the recent crisis, CFA UK is not persuaded that the next set of regulators will meet these requirements.

13. Is the Government's proposed approach to 'orderly' firm failure satisfactory?

On paper the approach appears sensible, although the government should provide concrete examples of how this approach would have delivered better outcomes than those used in the recent crisis. The approach is bank focused and further evidence should be provided should a major investment firm or insurance company fail. Perhaps the UK Government can provide a

[7] http://www.newyorkfed.org/research/staff_reports/sr458.pdf

case study of a hypothetical situation of demonstrating how the new framework would respond if a major bank or insurance company like AIG failed, and why such a failure might have been missed by the new framework.

14. Given that the PRA and the FCA will inherit FSA staff does the draft Bill do enough to ensure a new regulatory culture and a more proactive approach to regulation? Will these two new bodies have staff with the appropriate skills and expertise?

Please see our answers to questions 4 and 11.

15. Are the FCA's primary objectives appropriate? Is significant emphasis given to the promotion of competition?

The FCA's approach is fine on paper but too much is demanded of it. The FCA is being asked to do too much and it will probably lack the resources to act effectively. The promotion of competition needs to be reframed with the emphasis on quality rather than quantity. The time has come to improve the quality of the market. The FCA should ensure that together with the PRA and FPC, it achieves the aims we have set out in our summary.

16. Are the responsibilities of the FCA towards the regulation of markets appropriate?

Please see our response to question 15.

17. Does the draft Bill strike the right balance between the responsibilities of consumers and firms? Are the FCA's new powers in the area of consumer protection appropriate?

Please see our summary.

18. Are the prudential regulatory responsibilities of the FCA towards FCA-only regulated firms given sufficient emphasis and detail?

The FCA has a considerable remit. The responsibilities may be well defined, although we remain to be convinced that the FCA has the expertise, skills, resources and courage to act decisively when it matters. More evidence is required from the FCA to demonstrate how it and the new framework would have delivered a better outcome had the proposed architecture been in place instead of the tripartite system.

19. Will the new regulatory arrangements reduce the risk and cost of dealing with the miss-selling of financial products?

The new framework does not demonstrate that the key lessons from history have been learned.

20. Are the proposals for co-ordination between the PRA and FCA clear and adequate? What would be the advantages and disadvantages of having a Single Point of Contact and/or a joint rule book for dual-regulated firms?

With firms that will be dual regulated it would be better to maintain the current system of a single contact that was fully aware of each firm's business and operations, as well as the extent to which the firm complies with the spirit of the regulation. Having one person look at prudential regulation and another at conduct can create a regulatory gap and myopia that

could result in regulatory inertia. Firms in the PRA remit will have two regulators to deal with and this could double the risk of capture. Prudential regulation is important, although firms willing to take prudential regulatory risks will be seeking to undertake conduct that may well be not in the spirit of the regulatory requirements. The quality of conduct and appropriate firm governance will determine whether or not the new framework is successful.

21. How do the proposals in the draft Bill fit within the new European regulatory regime? What freedoms and constraints will the UK have to operate within that regime?

The UK has an excellent opportunity to demonstrate practical leadership in the area of financial services regulation, although based on our assessment, this has been an opportunity missed.

22.Does the draft Bill contain any proposals or omissions, not covered by the questions above, which cause concern?

Please see our summary and basis for response at the beginning of this document that set out the key omissions and the risks of repeating the mistakes from the past.

We trust that these comments are useful and would be pleased to meet the Joint Committee staff to explain them or to develop them.

Yours,

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Chair Professional Standards & Market Practices
Committee, CFA UK

Will Goodhart
Chief executive
CFA Society of the UK

Appendix 1 – Prominent events of systemic governance failure from the last thirty years

Crises	Governance failure	Market failure	Regulatory failure
Latin American debt crisis of the 1970s and 1980s	US and UK banks excessive lending to developing economies.	Market discipline failed to account for the impact on balance sheets of banks excessive risk taking.	Regulators noticed the potential for systemic risk although did not act until it was too late.
The property market busts of the late 1980s and early 1990s. U.S Savings and Loans Crisis of the late 1980s following the property bust.	As property prices increased, lending became more lax and dependent on the future price appreciation. Little account was taken of what would happen to borrowers if interest rates rose.	In a deregulated environment for S&L institutions, there was little to prevent these institutions extending ever riskier loans.	Post deregulation there was little oversight on S&Ls until it was too late. Congress had to take action with taxpayers providing 80% of the $153B clean up costs.
Japan - bursting of the real estate and stock price bubbles in 1990.	Banks failed to take into account the risks generated by lending that relied on future rises in equity and real estate prices into the future.	The interdependence of property and equity markets meant that reputational intermediaries had a vested interest in sustaining the unsustainable.	Regulators were unwilling or unaware of the risks being built up in their financial system as a result of speculative related lending.
The bankruptcy of "titan" investment bank Drexel Burnham Lambert in 1990. Drexel was the most profitable firm on Wall Street in the 1980s. Prior to its bankruptcy, Drexel paid the largest fine at the time under the Great Depression securities laws for mail and securities fraud.	Pioneer of high yield or junk bonds. Drexel was able to provide credit to companies that were unable to access it elsewhere. Overreliance on "junk bond" financing exposed the bank to many risks and inappropriate practices. Drexel also is reported to have issued the first Collateralised Debt Obligation (CDO).	Yield chasing financial institutions were attracted by the high yield on offer enabling Drexel to become a major source of funding for Leveraged Buyouts (LBOs). Drexel and "junk bond" pioneer Michael Milken became the "junk bond" market.	Regulators did act decisively only after being tipped off by one of Drexel's competitors. The investigation revealed a major insider trading network. Drexel was unable to recover and was allowed to fold. However, despite holding Drexel to account and the indictment of "junk bond king" Michael Milken; regulators could have done more to ensure that the types of practices uncovered by the Drexel investigations became less attractive for firms to undertake in the future.
Russia's domestic debt default in 1998 which started a chain of events that resulted in the fall of Long Term Capital Management (LTCM).	Shock events such as Russia's default were outside the realm of LTCM's models. When risk was being taken off the table, highly leveraged funds like LTCM suffered a double whammy as its long positions declined in value and its short positions rose in value.	LTCM was able to generate high levels of leverage on very loose terms because of the partners of the firm. The risks associated with LTCM and other funds following similar trading strategies in markets where liquidity was low was also not factored in.	Regulators were unwilling/unaware of the consequences of investor panic on banks that terms for LTCM's borrowing. With fears of a potential systemic meltdown, the New York Federal Reserve orchestrated an injection of private capital into LTCM to prevent further market disruption. This not only averted further panic in the market but may have also increased the moral hazard.
The dot.com bust in 2000/2001.	Capital was allocated to companies that would deliver profits at some unspecified date in the future. The arrival of the internet coincided with	As the dot.com boom took hold, the general level of equity prices also rose, which resulted in inflated equities being used as currency to	Regulators did not understand that the inflation of the dot.com bubble indicated inappropriate practices that were detrimental to clients' interests that affected the equity

	thoughts of the New Economy where Macroeconomic risks would be less also prevailed.	fund merger and acquisition activity; WorldCom being a notable example, AOL/Time Warner being another.	and non-equity markets. Regulators singled out symptoms of the problem such as equity research rather than the root cause of why capital was being misallocated..
Argentina's debt default in 2001 (the largest in history at that time).	Argentina's attempt to control inflation by having a fixed exchange rate to the US dollar imposed an economic stranglehold. In order to maintain monetary credibility, successive governments faced fiscal and political difficulties that were insurmountable even with IMF/World Bank support. Eventually, the government was forced to default on $132Bln of public debt and devalue its currency.	At first the IMF/World Bank support was seen as supportive and this may have played down the default risks associated with Argentina. However, in time market participants factored in the prospect that default was inevitable. Perhaps, market discipline could have been more effective sooner and may have reduced the severity of the measures Argentina eventually had to take.	The regulator failure was more government failure. Political instability and the desire to maintain monetary credibility at all costs being the key causes of Argentina's financial crisis.
2001-2006 Major corporate governance scandals e.g Adelphia, Enron, Royal Dutch Shell, Parmalat, Livedoor.	The checks and balances within companies was called into question following the revelations at Enron, Royal Dutch Shell and Parmalat. It was found that these companies' senior management were engaged in inappropriate activities to portray themselves in the best light.	The collapse of Enron was especially alarming as it resulted in the downfall of its auditor Arthur Andersen and in multi-billion dollar settlements by some banks without admitting any liability.	Regulators were caught unawares of the type of practices that took place in companies like Enron. In addressing the problem the US regulators focussed on the symptoms rather than the root cause. The Sarbanes Oxley Act was the result and the jury is out about its effectiveness.
Banking crises 2007-2009	The internal checks and balances within major banks that enabled them to engage in the expansion of credit that relied on cashflows of ever deteriorating quality.	The financial system relied on an illusion of comfort created by risk transfer. Risk was being underpriced and as a result market discipline was not being imposed.	Regulators were unaware of the risks that were being built up and mistakenly relying on market discipline to provide the appropriate checks and balance.
Periphery Eurozone sovereign debt crisis 2010/2011.	Periphery Eurozone economies had cosmetic fiscal health that was enhanced by economic growth and easy access to finance, One country also engaged in budget data management to ensure it would meet the fiscal criteria.	The illusion of monetary credibility provided by Eurozone membership and risk transfer it implied; enabled market participants to downplay the economic and fiscal risks inherent in these economies. Convergence trades trumped fiscal scepticism. Lack of enforcement of the Maastricht treaty was not penalised.	Little credible threat of the Maastricht Treaty being enforced. Periphery Eurozone governments were unaware or overlooked the economic risks they could face, while regulators overlooked the impact of their fiscal difficulties on the balance sheets of banks that were holding periphery Eurozone debt. Contagion risk was also overlooked.