Message to Brussels regulators – if it’s not broken it does not need fixing

By Simon Lewis, Chief Executive, AFME

While political and media attention in recent months has been focused on calls for further controls on bankers’ pay and ideas for imposing new taxes on the financial sector, in Brussels officials have been steadily pushing along a potentially more significant piece of regulatory reform. This work – a review of the effectiveness of the four year-old Markets in Financial Instruments Directive (MiFID) - could have a significant impact on both financial firms and their customers, such as pension funds, private investors and companies that trade internationally. The Commission’s formal consultation on the Review has just closed and work will now begin on turning its proposals into legislation.

When it came into force in 2007, the original MiFID’s objective was to create a single efficient market in financial services across the EU, with harmonised trading requirements, increased transparency, increased competition and lower costs - all in the interests of encouraging and protecting investors and improving market integrity. In other words, MiFID aimed to create a level playing field so that an investor in Athens has the same opportunities and protections as one in Aberdeen.

The Review should conclude that those aims have been partly met. Certainly, MiFID has brought significant overall benefits to consumers and users of wholesale markets and to larger firms operating internationally. It has made cross-border investment business in the EU easier and increased competition and innovation while reducing trading costs.

So far, so good. But rather than confine itself to its stated purpose, the current Review appears to have in mind new objectives. While the original rationale for the Review related to market fragmentation and improvements in investor protection, the consultation paper that resulted went much further Many of the
proposed policy changes are disproportionate to the regulatory problems at which they are aimed.

One of the many areas of concern is the move towards a “one size fits all” approach to the trading of financial products and asset classes. As the original MiFID was largely focused on the equity markets, the model successfully used there has been applied to products as diverse as Foreign Exchange (FX) and Over-the-Counter Derivatives, despite the fact that these products have very different purposes and therefore equally different characteristics and potential risks. Indeed, as AFME argues in its comprehensive submission to the Commission, the global FX market already displays many of the (risk management) characteristics sought by MiFID, without the need for regulation. This seems to ignore one of the guiding principles of regulation; that any new rules be aimed at addressing a market failure or imbalance. In this, and many other instances, the MiFID Review has overlooked the adage that if something is not broken it does not need fixing.

Were this view held only by those in the business of selling products, one could forgive a degree of scepticism. However, investors are also demonstrating concern. A recent survey of investors in fixed income products, conducted by AFME, found that 74% felt that the MiFID Review proposals on the publication of the prices at which trades had been made would actually reduce competition. This view, incidentally, was shared by 67% of dealers. Strikingly, every one of the investors we surveyed said that the proposals would result in worse pricing for themselves.

So, we have the perfect storm: a proposal for substantial change, misgivings from both investors and dealers and, of course, the potential for considerable increases in the cost of compliance for the market practitioners and in the cost of trading for their customers, whether they be private investors or institutions such as pension funds.
Happily, the ink is not yet dry on the Review, but time is running out. The consultation period has already been short, presumably because regulators are under pressure from politicians to accelerate reform. Over the next few months officials will be working their way through what is likely to be a large pile of submissions from interested parties. On behalf of our members, who include the majority of European wholesale financial firms, we will be trying to persuade those officials to reconsider many of the proposals, but I would also call on other stakeholders, particularly from the investor community, to make their concerns heard. As Mark Hoban, the Financial Secretary to the Treasury said at an AFME conference earlier this month, if we want to see a robust European regulatory framework that supports competition and open markets then the industry must provide engagement, evidence and positive ideas for reform.

Regulation needs to keep pace with changing market practices and technological developments, so it is right that existing rules should be reviewed and we agree that regulatory improvements are needed in some areas. But it is vital that any proposed solutions address real problems, are supported by robust impact analysis and maintain user choice, innovation or competition. Getting this balance right will be a difficult task for the regulators, but the financial services industry, both “buy side” and “sell side”, is committed to helping them do so. MiFID is too important to the health of the European financial markets for them not to succeed.

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