

WMBA and LEBA Response to FSA Consultation on HMT Consultation entitled “A New Approach to Financial Regulation”

Introduction

The Wholesale Markets Brokers' Association (WMBA) and the London Energy Brokers' Association (LEBA) (*together* "WMBA") are the European Industry Associations for the wholesale intermediation of Over-The-Counter (OTC) markets in financial, energy, commodity and emissions markets and their traded derivatives. Our members are Limited Activity/Limited Licence firms (under CRD) that act solely as intermediaries in the said wholesale financial markets. As Interdealer Brokers (IDBs), the WMBA members' principal client base is made up of global banks, primary dealers and energy companies. The comments below should be seen in the context of WMBA members acting exclusively as intermediaries, and not as own account traders. (Please see www.wmba.org.uk and www.leba.org.uk for information about the associations, its members and products).

Overview

The WMBA welcomes the proposed amendment to the UK regulatory structure outlined in the Treasury document "*A New Approach to Financial Regulation; A Blueprint for Reform*" and the opportunity to provide input into the Consultation. Despite the uncertainty raised in the next paragraph, our response is made from the viewpoint of our Limited Licence/Limited Activity firms operating in the wholesale markets and who WMBA consider should in future be supervised by the Financial Conduct Authority.

The recent BOE/FCA consultation paper titled "*A New Approach to Regulation*" stated that the Prudential Regulatory Authority (PRA) will be responsible for a small number of significant investment firms. However, Margaret Cole (FSA), in her speech on 28th June 2011 when launching this paper, also indicated "*for both conduct and prudential regulation, there is likely to be a small number of firms which will require a more active supervisory programme. This will apply to firms whose failure, even if orderly, could threaten the integrity of particular markets. One such example is **Interdealer Brokers***".

As you have read above, an Interdealer Broker only ever acts as an intermediary between typically wholesale counterparties such as banks. As IDBs are not authorised to take a proprietary position at any stage, our risk profile is such that it raises the question as to how, in the quote from Margaret Cole, IDBs could threaten integrity in the wholesale markets. Operating such a straightforward business model and in parallel competition to each other, would ensure in our opinion, that any failure would more than likely cause no discernible impact on the wholesale markets.

An IDB also has no retail clients. In light of this, we would seek clarification as to the definition of a "*significant investment firm*". It has been suggested that IDBs are to be included within a putative classification of "Financial Market Infrastructures" (FMIs) including market intermediaries such as Regulated Exchanges, MTFs and post-trade settlement and clearing systems. Such classification may be jointly regulated by both PRA and FCA. Respectfully, we would again request clarification of whether such a regime is being considered. Following on from this, we also request clarification of the extent to which HMT considers IDBs may create or mitigate systemic risk.

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The WMBA welcomes the recognition in this paper:

- (a) that *"financial services is one of the key sectors of the UK economy" and "as an employer and contributor of tax revenues, as an exporter of UK services to the rest of the world, and as a vital part of the economic infrastructure, a healthy financial sector is an important driver of growth in the UK"* (paragraph 1.1);
- (b) that the potential for significant risks posed by such a financial service sector and the severe impact of the recent financial crisis calls for the kind of *"targeted policy responses"* identified in paragraph 1.5 and a fundamental strengthening of the system *"by promoting the role of judgement and expertise"* (paragraph 1.13); and
- (c) that in order to develop an appropriate and workable programme of reform, the Government must *"work closely with all stakeholders"* (paragraph 1.15).

However, in respect of the burden of regulation, the WMBA are concerned that the difference between the requirements of wholesale and retail markets are not fully recognised by the FCA and would reiterate the Government's assertions in its previous consultation paper "A new approach to financial regulation: building a stronger system" (Cm8012), namely:

- (a) that *"the key to any new regulatory approach should be proportionality, the principle that a burden or restriction imposed on a person or activity should be proportionate to the benefits which are expected to result"* (paragraph 4.25);
- (b) that policy-makers must *"think carefully about the case for regulation"* and, where intervention is required, to explore in full the opportunity for non-regulatory and self-regulatory approaches before considering regulatory measures (paragraph 3.66-7);
- (c) that the new regulators must be *"rigorous in their analysis of the impact of regulation on industry"* (paragraph 3.67);
- (d) that regard should be paid to the *"potentially negative effects of excessive regulation on market efficiency and consumer choice"* (paragraph 4.9); and
- (e) that the new infrastructure must be able to operate in a way that delivers coherence, efficiency, effectiveness and *"the best value-for-money solution for the financial services sector"* ("A new approach to financial regulation: judgement, focus and stability" (Cm7874)).

WMBA also welcomes HMT's intention to ensure that there is full and effective co-ordination between the various bodies that have macro and micro supervisory powers.

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Detailed Comments

Q1. Do you have any specific views on the proposals for the FPC as described above and in Chapters 3 and 4?

The WMBA generally supports the views and objectives laid out in Chapters 3 and 4. The WMBA would reiterate its view that governance of the FCA is “too heavily weighted” towards the retail consumer sector at the expense of wholesale markets supervision.

We repeat that the concept of a “*Wholesale Consumer*” is flawed and indeed may lead to development of less utile financial market infrastructures ultimately damaging the competitiveness of the UK. Wholesale markets are professional and eligible and need to be defined and treated in a very distinct manner from retail markets. This issue is of crucial importance to the UK in a way that doesn’t apply elsewhere due to the position of London as the hub of the world’s wholesale financial markets.

Q2. Do you have any specific views on the proposals for the Bank of England’s regulation of RCHs, settlement and payment systems as described above and in Chapters 3 and 4?

The WMBA generally supports the views and objectives laid out in Chapters 3 and 4.

We do however note that there is no resolution regime for systemically important Financial Market infrastructures [FMIs] such as CCPs; and these need to be developed in parallel to those in the banking system and before adequate supervision can be established by the Bank of England.

Q3. Do you have any comments on the proposed crisis management arrangements; and the proposals for minor and technical changes to the Special Resolution Regime as described above and in Chapters 3 and 4?

As per Q2 above.

The WMBA notes that there is no resolution regime for systemically important Financial Market infrastructures [FMIs] such as CCPs; and these need to be developed in parallel to those in the banking system and before adequate supervision can be established by the Bank of England. Further, such arrangements need to be recognised and suitable for the framework being established by the European Commission, and to be able to passported out to jurisdictions beyond the EU.

Q4. Do you have any comments on the objectives and scope of the PRA, as described above and in Chapters 3 and 4?

The WMBA supports:

- (a) Recognition in Cm8083 of the need for regulatory policy and processes to be appropriately tailored to different types of firms; and

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- (b) rejection of a “zero-failure” approach to regulation, which would have to be so restrictive in terms of risk, innovation and choice as to undermine the Government’s recognition in paragraph 1.1 that “a healthy financial sector is an important driver of growth in the UK”. We note that IDBs operate in healthy competition and this environment of necessary high performance contributes not only to resilience, but also to both utility and efficiency.

Q5. Do you have any comments on the detailed arrangements for the PRA described above and in Chapters 3 and 4?

The WMBA supports HMT views that:

- (a) the importance of effective information-sharing with the FCA can empower a continuation of a principles-based, as well as a rules-based authority
- (b) that all such judgements should be “rigorously evidence-based” and should embody the principal of “consistency of decisions”
- (c) that “*the PRA board must provide a robust challenge to the executive*”
- (d) the National Audit Office should undertake value-for-money studies of the PRA and FCA

Q6. Do you have any views on the FCA’s objectives – including its competition remit – as set out above and in Chapters 3 and 4?

The WMBA supports the Financial Conduct Authority’s (FCA) strategic objective of protecting and enhancing confidence in the UK financial system and its three operational objectives:

- Securing an appropriate degree of protection for the consumer;
- Promoting efficiency and choice in the markets for financial services; and
- Protecting and enhancing the integrity of the UK financial system.

The WMBA welcomes HMT’s recent statements in respect of key expressions of regulatory policy and notes that it is the FCA’s stated position to “recognise that there are important differences between wholesale and retail markets” (Paragraph 3.5) and “will adopt a differentiated approach to protecting different categories of consumers” (Paragraph 3.6). However, the WMBA stresses the importance of making sure that these statements are made good in practice and, therefore, that the FCA embraces proportionality and avoids ‘scope-creep’. In light of the wider retail mandate given to the FCA, we highlight the risk that in focusing too strongly on retail issues, the unintended consequence of regulatory COB burdens that are not proportionate or relevant to wholesale market participants may result. For this reason, the WMBA would urge HMT to ensure that there is a continuing and objective balance to the role and processes of the FCA with regards to both regulated firms and consumers and whilst remaining a priority investor protection, and consumer interests should not become the sole perspective of the FCA.

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The WMBA welcomes the proposal that the FCA will have a strong new role in promoting competition, efficiency and choice and notes the Government's recognition of *"the importance of competition as the best driver of good consumer outcomes"* and its intention to *"increase the profile of competition issues in a regulatory system"* (paragraph 1.8 and 1.41).

In particular, the WMBA notes the Government's intention:

- (a) to empower the Office of Fair Trading to consider to what extent competitive inefficiencies in specific markets are generated by structural barriers or other anti-competitive elements (paragraph 1.8 and 1.41);
- (b) to give the FCA a wide-ranging competition mandate *"which will place competition concerns at the heart of the new conduct regime"*;
- (c) to empower the FCA to initiate *"an enhanced referral to the OFT where it has identified a possible competition issue"*, including issues that may be generated by structural market features or anti-competitive business practices (identified in relation to Q10).

However, in order to deliver the HMT's regulatory objectives, the WMBA would urge HMT to reconsider its position regarding the importance of competitiveness and include its facilitation as a key objective for both the FCA/PRA. Whilst the WMBA concur with the Government that financial stability is indeed the platform for sustainable growth and success, this does not remove the specific need for a regulatory recognition of the importance for UK firms to remain competitive and for authorities to pay due regard to the need to facilitate and foster competitiveness. It is difficult to see how both the PRA and FCA can perform the more commercially judgemental and interventionist role expected of them in the future, which will involve taking decisions on commercial matters, reviewing business models and products, and judging growth strategies, without being required to take into full account the need for those same institutions to maintain not just their international, but also their domestic competitiveness

With regards to competitiveness, the current wave of mergers across market infrastructures will likely establish monopolistic or near-monopolistic providers of essential market services and that their position and ability to dominate the market will be enhanced significantly by regulatory policy designed to encourage as much trading as possible to take place on organised trading venues, financial market infrastructures and to be centrally cleared by CCPs (*most of which are vertically integrated within exchanges*). Current market and regulatory momentum are delivering increasingly dominant positions for market infrastructures in execution, clearing, post-trade and market data services. All of these will impact on rights of clearing access, the pricing of services and facilities, the cost of (*and conditions of access to*) market data, the basis for licensing indices and the capability of new market infrastructure entrants to compete in execution and clearing.

The empowerment of FCA to independently monitor the behaviour of infrastructures relevant to market competitiveness and efficiency and choice in market services, the setting of fees and the terms and conditions for issuing licenses and affording access will

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be a critically important discipline on infrastructures with considerable market power and will play a key role in delivering on FCA objectives of market integrity and efficiency.

Q7. Do you have any views on the proactive regulatory approach of the FCA, detailed above and in Chapters 3 and 4?

The WMBA supports the need for a more proactive approach to conduct regulation with a “clear focus on consumer outcomes”, but subject to standards of proportionality which would reflect:

- (a) the category of consumer, e.g. retail or wholesale; and
- (b) the need for firms to be competitive and pro-active in terms of service and product innovation in what is a highly competitive environment.

HMT needs to ensure that FCA carefully segments the market so that there is sufficient expertise within each segment. The team responsible for each sector must actively and continuously engage with trade associations and firms to maintain their specialist knowledge and identify market developments.

The WMBA support the Government’s observations in “A New Approach to Regulation; Building a Stronger System” that product intervention powers are “unlikely to be appropriate in relation to wholesale market consumers”; however, they are concerned that the recent FCA consultation indicates that product intervention in the wholesale markets must be considered “to the extent that wholesale products filter down or are distributed to wholesale clients”.

Q8. What are your views on the proposal to allow nominated parties to refer to the FCA issues that may be causing mass detriment?

No Comment

Q9. What are your views on the proposal to require the FCA to set out its decision on whether a particular issue or product may be causing mass detriment and preferred course of action, and, in the case of referrals from nominated parties, to do so within a set period of time?

No Comment

Q10. Do you have any comments on the competition proposals of for the FCA set out above and in Chapters 3 and 4?

The WMBA support the Government’s observations in respect of competition and refer to the response to Question 6 above.

Q.11 Do you have any views on the proposals for markets regulation by the FCA, described above and in Chapters 3 and 4?

The WMBA welcomes the fact that the approach to the supervision of markets by the FCA will largely be a continuance of the same approach currently adopted by the FSA,

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and that its primary focus will be principals based, participant based, and on the integrity plus efficiency of markets and in providing a level playing field.

Q12. Do you have any comments on the governance accountability and transparency arrangements proposed for the FCA, as described above and in Chapters 3 and 4?

The WMBA welcomes the proposals put forward by the Government, including particularly the proposed six principles of good regulation to which the FCA must have regard, i.e. efficient use of resources, regulatory proportionality, consumer responsibility, senior management responsibility, openness and transparency.

The FCA has provided the assurance that its judgements will be “reasonable and proportionate”, we support the fact that its regulatory decisions will nevertheless be subject to an effective appeals mechanism, e.g. the scrutiny of an Independent Tribunal.

Q13. Do you have any comments on the general co-ordination arrangements for the PRA and FCA described above and in Chapters 3 and 4?

The WMBA the need for effective co-ordination and welcomes the fact that the Bank and FCA will be publishing a document later this year setting out more fully their plans to deliver “operational co-ordination” and that a key purpose of the general duty to co-ordinate is to “minimise unnecessary overlap, duplication and regulatory burden”.

Q14. Do you have any views on the detail of specific regulatory processes involving the PRA and FCA, as described above and in Chapters 3 and 4?

With regard to the issue of enforcement, there is a clear tension between the FSA’s understandable drive to develop credible deterrence sanctioning, the principle that the punishment should fit the crime, i.e. sanctioning proportionality, and the right of individuals to be able to reasonably predict the consequences of their actions.

We have as an Association repeatedly asked the FSA for clarity in respect of its approach to Market Abuse in the Wholesale non-equity markets and it is clear that this is still in development beyond the confines of short selling within the equity markets. As such the escalation of prosecutions in number, complexity and their criminal reach needs to be in step and proportional to the clarity of the approach.

Q15. Do you have any comments on the proposals for the FSCS and FOS set out above and in Chapters 3 and 4?

The WMBA has no comments

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Information on the Associations

Operating as the hub of the global financial market infrastructure, Interdealer Brokers (IDBs) are MiFID compliant and highly regulated intermediaries by virtue of their regulatory authorisation and from being subject to supervision under CRD as Limited Activity firms. Our members are neutral, independent, and multi-lateral and provide free, fair and open access to their trading venues for all suitably authorised and regulated market participants. IDBs do not take positions in the markets they operate in and their collective service as the gateway to the global financial marketplace creates price discovery and significant liquidity. All transactions, whether executed via voice, hybrid or fully electronic means, are immediately captured at the point of trade, are subject to straight-through-processing, and are made available for transparent and timely transaction reporting to the relevant regulators.

The WMBA have restricted their comments to the topics that are relevant to their members and hence on which they have the relevant experience

WMBA Members:

- BGC Partners
- GFI Group Inc.
- ICAP plc
- Martin Brokers (UK) Ltd
- Reuters Transaction Services Ltd
- Sterling International Brokers Ltd
- Tradition (UK) Ltd
- Tullett Prebon plc
- Vantage Capital Markets LLP

LEBA Members:

- Evolution Markets Ltd
- GFI Group, Inc
- ICAP Energy Ltd
- PVM Oil Associates Ltd
- Spectron Group Ltd
- Tradition Financial Services Ltd
- Tullett Prebon Energy Ltd

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