

Response to HMT

A new approach to financial regulation; judgement, focus and stability

1. The Wholesale Market Brokers' Association (WMBA) and the London Energy Brokers' Association (LEBA) 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 firms that act solely as intermediaries in the said wholesale financial markets. As Interdealer brokers (IDBs), our members' principal client base is made up of global banks and primary dealers. The replies below to the questions in the paper should be seen in the context of member firms acting exclusively as intermediaries, and not as own account traders. (Please see www.wmба.org.uk and www.leba.org.uk for information about the associations, its members and products.) For this reason some of the questions in the CP are not entirely relevant to member firms' activities even though they are to most of their clients. Further, some answers take into account industry views and experience.
2. WMBA/LEBA notes and supports the analysis of the recent financial crisis (1.2) and the identification of weaknesses in the 'tripartite' system (1.4). It believes that it is right to identify and carefully define the roles of Macro-prudential regulation for maintaining financial stability, and the (Micro) Prudential regulation of individual firms (1.9 – 1.18). WMBA/LEBA feels that it is essential that this differentiation should be reflected in the way in which the CPMA works in practice, and how it engages with ESMA (5.2).
3. Whilst WMBA/LEBA favours the FPC having '...a single clear, unconstrained objective....' in principle (Questions 1-3), it notes the papers comments on the failures of the tripartite system and would stress the importance of a transparent MOU to define the operational interaction between the FPC, PRA and CPMA. This may mean in practice that secondary factors should be taken into consideration to avoid the 'underlap' identified by Lord Turner and Paul Tucker, but it is not clear why these need to be formulated in legislation. To do so might mitigate against the operational interaction required to avoid the mistakes previously made within the tripartite system.
4. The Association notes the potential macro-prudential tools (box 2.C) available to the FPC, but would like the paper to be equally specific on what micro-prudential tools would be considered. All of the macro-prudential tools considered would need to be applied to individual firms on a selective basis depending on the nature of the firm and the risks identified. It should be made clear what responsibilities the FPC assume for such an application. (See 3. Above).

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5. WMBA/LEBA particularly endorses the suggestion that the PRA should '....focus more on understanding institutions business models and strategies....' and believes that the PRA should have regard to the primary objectives of the CPMA and FPC (question 4). The FSMA principles for good regulation should be retained for the PRA, and the Association feels strongly that the PRA should have regard to the stimulation of competitiveness and innovation inherent in the UK financial system.
6. The Associations support the model proposed in 3.16 but would underline the necessity of the PRA and CPMA working closely together (question 5). It would stress the need for the model to take compliance costs for firms into account and to minimise bureaucracy.
7. The approach to the transfer of regulatory functions and rule making powers (3.17-3.23, questions 6-8) are noted and understood. WMBA/LEBA believes that any safeguards required are unlikely to be greater than those currently outlined in the FSMA, but would urge the PRA and CPMA to confirm adherence to an approach based on principle and risk based supervision.
8. WMBA/LEBA notes that the CPMA is a 'working title' and would point out that the practicalities of how the FPC, PRA and CPMA work together are of overarching importance. Within this constraint, it agrees that the CPMA should have regard to the stability of firms and the financial system as a whole by reference to the primary objectives of the FPC and PRA (question 10). The Association is concerned that not of enough distinction is made between retail and wholesale markets and suggests that COB rules (e.g. relating to TCF and Market Abuse) are applied proportionately. It also believes that the CPMA should have regard to any issues that relate to the competitiveness and innovative capacity of the UK financial services sector.
9. The accountability mechanisms for the CPMA are noted and considered appropriate as far as they are laid out in the paper (4.36 – 4.39). WMBA/LEBA urges that membership of the three proposed panels, particularly the practitioners panel, takes full account of the wholesale and international nature of the businesses regulated (questions 11-12). The proposed funding arrangements should also take full account of nature of the firms and the weight of business and supervisory resources applied to their regulation (question 13).
10. WMBA/LEBA welcomes the explicit requirement 'related to the promotion of market efficiency and integrity', and the 'recognition of the differences between retail

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financial services conduct and wholesale financial markets conduct' laid out in 5.9 – 5.10. It notes that its members industry sector (Inter Dealer Brokers, please see Introduction) is not specifically mentioned in the participants in section in 5.8, but assumes that their activities are included in that definition as participants in 'OTC financial markets in which off-exchange dealings take place between bilaterally between financial institutions and other large wholesale market participants'. It urges the markets division of the CPMA to ensure that it is responsible for all firms active in wholesale traded and financial markets, and that they are regulated and supervised within the framework of a consistent approach to principles and risk based supervision, in order to avoid a fragmented approach to wholesale market regulation (questions 15-16). WMBA/LEBA further suggest a review of the application of Pillar 2 of Basel II and III (through the CRD) to Inter Dealer Brokers, and the use made of the Supervisory Review Evaluation Process (SREP) and ARROW risk assessments.

11. WMBA/LEBA notes and supports the plans for crisis management and the transition process laid out in box 6.A. It believes that major crises are likely to be international in nature, especially for the nature of its members business, and notes the comments made in 6.25 – 6.30. It hopes that the roles and responsibilities of international bodies, particularly within the EU, demonstrate clear lines of authority and distinguishes between Macro and Micro-prudential actions (questions 19 – 21).

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