Event Recap: EU Policymakers’ Series – Shaping European Regulation

STRASBOURG DINNER 12TH JUNE HOSTED BY GAY MITCHELL (MEP)

Summary
ITG was pleased with the opportunity to arrange for Gay Mitchell (MEP – Dublin) to host the dinner for seven other MEPs and clients of ITG. ITG is extremely thankful to Gay Mitchell for having arranged for a dinner with such a key group of MEPs who, in turn, are deeply involved in the review of the European Commission’s financial services legislative proposals.

The European Commission’s proposed legislative agenda address a number of vital areas for the financial services industry which will also impact Europe for the next decade. These include market structure issues (such as those contained in Markets in Financial Instruments Directive II/ Markets in Financial Instruments Regulation (MiFID/R II) and European Market Infrastructure Regulation (EMIR)), investor protection issues (such as Undertakings for Collective Investment in Transferable Securities IV/V (UCITS IV/V)), taxation (the European Financial Transaction Tax) and prudential regulation (e.g. Banking Union and the implementation of the Basel III process through the Capital Requirements Directive IV).

The informal and inclusive format of the dinner offered those in attendance the opportunity to voice their comments and questions to the whole gathering and not just those who were sitting nearby. The discussion became very lively and offered ITG’s clients a rare opportunity to see MEPs hotly debate (in a friendly environment) a number of issues that will fundamentally impact the European financial services industry.

Discussion topics
The discussion began by addressing the outlook of regulation on the European Union’s (EU) pension fund industry. A consensus of diners agreed that it was important for buy-side market participants to engage with policy makers. However, some MEPs suggested that fund managers do not engage enough with policy makers.
The specific nature of fund management industry was also discussed, with attendants highlighting the diverse range of funds and clients that each company deals with. It was understood that this can lead to difficulties in presenting policy makers with a clear solution to regulatory problems, which would be effective across the industry. The EMIR pension fund exemption was particularly discussed in this regard.

However, for many of those clients present, MiFID was their key concern. There was general agreement that market transparency is crucial to the smooth running of the market and, that it is generally something policy makers should aim for so long as (using an MEPs expression) there is 'no friction' and (ironically suggested by one particular client) as long as their relevant firm was not the one required to comply with any such transparency obligations.

In particular, several clients expressed concern about the lack of a coherent transparency waiver regime in the current drafting of the European Parliament’s position on MiFID. It was also suggested that the European Council’s text may not be any more helpful to the industry. In this respect, the need for both a pre-trade waiver for large orders and, post trade exemptions from certain reporting requirements were considered crucial, as was the reference price waiver. Without those transparency exemptions, clients considered that liquidity would be negatively impacted (in particular in the illiquid markets).

There was discussion of the relative size of the bond market and outsized negative impact that the transparency proposals will have in that area. Other industry participants were keen to stress that equities form an incredibly small part of their trading book.

Several clients also had concerns regarding the proposed rules to curb high frequency trading. The potential damage to the market of the 500milliseconds resting time requirement in the Parliament’s drafting of MiFID was discussed. Several participants suggested that this rules would not affect the high frequency trading strategies that the Parliament was hoping to address. It was also suggested that the increased costs of algorithmic trading would end up being paid by the end consumer.

Inducements were also raised as being a key issue for the fund management industry. It was clear that this had been a key debate in the Parliament and, that the issue would in all likelihood continue to be discussed in the Trilogue negotiations between the Parliament, Council and Commission.

For several diners the FTT was also a key concern. Everyone at the dinner agreed that the current proposals could be damaging to the market. Observing the animated discussion that ensued, the participants were left with little doubt that none of the MEPs at the dinner had voted in favour of the Parliament’ report on the financial transaction tax. Certain of the MEPs commented that the vote had been very close and that the implementation of the Commission’s proposal would have a crucial impact on the functioning of financial markets. Several policy makers suggested that the FTT would not survive negotiations for much longer and, it was unlikely to become a reality. Lack of German support was cited as a key reason for this.

Nonetheless, in a threadbare client minority view it was suggested that the financial services industry has to accept responsibility for the crisis and, the FTT has to be seen as part of this. Credit Rating Agencies were suggested as another example.
The role of the fund management industry in long term financing was also raised as a key concern for policy makers. Certain MEPs suggested that this is an area where the fund management industry could have a positive impact on the European economy.

The current shortfall in the funding set aside by the European Union for infrastructure funding was raised by policy makers. This was seen as both a problem and an opportunity for regulators and industry to work together. MEPs expressed an interest in hearing from fund managers how they could better encourage this kind of investment.

The coherence of financial services legislation was also discussed. The need for a cumulative impact assessment across all such legislation was highlighted by several participants. It was suggested that current EU legislation does not make sense when considered in its entirety. Also, legislation needed to be more predictable in the long term. Clients considered that this problem was not helped by the lack of strategic, broader vision amongst policy makers.

**BERLIN LUNCH 13TH JUNE WITH DR. WERNER KERKLOH, GERMAN MINISTRY OF FINANCE**

For the second leg of the client outreach, ITG arranged for a client lunch with Dr. Kerkloh who heads the Insurance and Asset Management unit at the German Ministry of Finance. The lunch was organised as a smaller gathering so that each client would personally have an opportunity to interact with Dr. Kerkloh.

As part of the tour de table, participants gave an overview of how they perceived the German regulatory environment and their key concerns with both German regulation and Germany’s implementation of European Union (EU) regulation. It was suggested that Germany often considers that where the EU is not taking the action the German government would like, it has to lead the way by producing legislation at the national level.

Financial transaction taxes (FTT) were raised as a key concern. Several participants thought that the EU FTT was likely to fail, while others suggested there are not any other obvious policy solutions to the problems it aims to address.

Several participants also raised concerns over German legislation on High Frequency Trading (HFT). It was suggested that both the FTT and HFT legislation are agreed upon across the political spectrum, and so the national elections are unlikely to change the regulatory outlook on these issues.

Several participants spoke about their concerns with the German pension system. It was suggested that a government’s priority should be allowing people to retire earlier and on better terms and, that fund management was crucial to this. Although high standards of living in retirement were considered a crucial goal of regulation, the German pension system was understood as unnecessarily penalising private pensions being paid in full before the state retirement age. One participant considered that this is at odds with the goal of reducing the impact of the plans across Europe to make persons collect state pensions later in their life.

Portability and taxation of pensions were raised as crucial issues. Strengthening pensions in all three “pillars” (i.e. state pensions, occupational pensions and private pensions) across Europe has to be a priority.
Transparency of financial markets was also raised as a key concern. While industry representatives were broadly in favour of transparency, there was concern that indiscriminate application could lead to market distortion, and could severely harm liquidity.

The volume of regulation which now governs transparency in the world of asset management is in itself a concern for some asset managers. Many participants thought that there should be a proper review of existing legislation before additional market structure proposals are produced and forced onto market participants. It was also suggested that existing and incongruous financial services legislation requires better harmonisation.

The variety and different levels of sophistication of the underlying asset managers’ client base was also raised as a regulatory issue. There was concern that this issue is not sympathetically addressed in national and EU legislation. Transparency requirements, which can be adhered to by larger clients, are not easily applied to smaller clients.

It was suggested by several participants that the buy-side could do more to engage on these issues. As an industry which is broadly keen on harmonisation, it was suggested that they had a lot to offer the debate.

**BERLIN AFTERNOON MEETING 13TH JUNE WITH RALPH BRINKHAUS, DEUTSCHE BUNDESTAG**

The Berlin leg of the client outreach programme was completed with an insightful meeting with Herr Brinkhaus at the German Bundestag. Herr Brinkhaus is a Permanent Member of the key Finance Committee and is Rapporteur for Financial and Capital Market Regulation Issues within that committee.

ITG and our clients were invited to Herr Brinkhaus’ offices for a discussion on the barriers that fund managers encounter when seeking to invest in Germany. The participants identified a number of barriers. Central to these, is the role of traditional German family businesses, which still relies on long established bank financing relations and which forms a large bulk of the German economy. The meeting participants considered that those businesses were reluctant to issue equity as a source of financing. This reluctance, in turn, was considered to impact the focus with which German policy makers view the financial markets (with a bias towards delivering legislative structures that nurture global lending arrangements rather than an interest in making the equity markets deeper and larger).

The European Financial Transaction Tax (FTT) was also raised as a key concern. Support for the FTT by some German politicians was described as more religious than grounded on analysis. Participants acknowledged that there was huge public support in Germany for the tax but, this often ignored the question of who would end up paying for it. There was a broad consensus in the room that the tax was likely to be paid almost entirely by pension holders and retail consumers.

Separately, the bulk of the German public opinion and political focus has concentrated on how the tax will be spent. Industry and centre-right politicians, it was agreed, should try to move the debate away from this focus.
The FTT was considered by all participants to be potentially very damaging to markets and consumers. Acknowledging that shaping the debate entirely away from the imposition of a tax, it was suggested that a ‘stamp-duty light’ tax could be the solution. However, politicians will have to move away from the idea that the FTT could be used a source of funding government expenditure and other worthy causes.

Shadow banking (and how it will be defined) was also considered to be a key aspect of the financial services regulatory debate in the next few years. In this respect, it was also suggested that Germany would be looking for a leading role in the debate (even by becoming a frontrunner in proposing regulation). European institutions appear to find challenging the process of turning very broad ideas into detailed regulation. Participants considered that the German Parliament could be in a position to lead in producing detailed regulatory blueprints that could then be considered at a European level.

The discussion ended with suggestions of how the buy-side could better engage with politicians and policy makers. There was agreement that this starts with how firms do business and demonstrate to the public that it is value driven for the benefit of the real economy.