Comment w/c 13th January

Re-aligning retail investment regulation so it's fit for purpose, not Brussels

"I think it will be a clash between the political will and the administrative won't."

Yes Prime Minister (1987)

In view of the immense burden of regulation which has been thrust upon retail investment businesses, and therefore their customers, over the past 10 years, many might ask how the Woodford debacle could have been possible.

The answer is simple, and was provided by Mark Carney and George Osborne last week: most of that EU-driven regulation is not fit for purpose - it's the product of a gargantuan EU appetite for regulation. As William Hague once said some 20 years ago, when commenting on the democratic deficit and regulatory pre-dominance at the heart of the European Union, regulators only know how to do one thing and will do it in abundance: produce huge amounts of regulation.

So in this commentary we consider some of the opportunities to seriously lift that burden, and why some of the motivation behind its original construction was just political pipe dreaming.

The call to re-balance financial regulation is not just coming from Carney and Osborne, it's widely supported by senior management of the UK's leading investment businesses. Last Friday's Telegraph business section reported Nigel Wilson, Legal & General's Chief Executive, and Paul Feeney, boss of wealth manager Quilter, adding their support to Mark Carney's call.

The three industries most affected by overbearing regulation are banking, insurance and investment. It's necessary to look at each, and their constituent parts, separately in order to find that right balance - of being as far away as we can from European Union rules, without losing access to European markets post-Brexit. The new President of the European Commission, Ursula von de Leyer, is well aware of the plan to find this balance, and warned against losing equivalence before her meeting with Boris Johnson last week.

Banking is the industry requiring the greatest degree of equivalence, and that's a problem because it is hopelessly over-regulated at present. I recently heard of someone who lives in the Far East with a UK bank account with Coutts, the RBS subsidiary, for over 50 years who has been asked to close it. Anyone who has any type of non-standard banking requirements, such as family trusts, will have suffered likewise from endless compliance demands.

But banks' access to EU markets will be critical to maintaining London's pre-eminence in our time zone, so compromise will be necessary.

The insurance industry stands to benefit most from relaxation of financial service regulation, and it's clear from Legal & General's wish to 'nudge the envelope of equivalence' that it has every intention of exploring what's possible.

But it's the investment industry, and particularly retail investment, which should see the most change. Under MiFID 1 (the 'Markets in Financial Instruments Directive'), EU planners imagined firms operating pan-Europe, and therefore needing uniform investment regulation to ensure a level playing field. That's proved to be nonsense, a pipe dream which simply doesn't reflect the wish of citizens within each country to stick with the brands and languages which they know and love. In other words, we don't need European equivalence in retail investment: what we need for investor protection is additional measures to address the three principle risks:

- **Market risk** : requires a **comprehensive programme of financial education** ;
- **Liquidity risk** : requires restrictions on open-ended funds to keep them out of unlisted securities; and

- **Counterparty risk** : requires the wholesale introduction of collateral (security) for customer cash deposits (see **article written for City AM in 2013**).

But regulators have instead poured on burdens which miss the mark: first with MiFID 1, then the Prospectus Directive, and then MiFID 2. At one point, they even threatened to outlaw execution-only share-dealing, and The Share Centre had to ask its customers to email the responsible official in Brussels directly to protest. Thousands did, and the reverberations flowed back through UK Treasury ministers to confirm the impact: the proposal was dropped forthwith.

Commenting on the current debate, Richard Stone - The Share Centre's Chief Executive - says: "With Brexit now being delivered, there is a real opportunity to ensure financial services regulation is fit for purpose for the UK investment market. Capital markets on the continent do not have the same history of retail investor participation and there is therefore an opportunity to make provisions currently contained in regulations such as MiFID 2 more proportionate and investor friendly to encourage continued, and greater, participation in capital by individuals".

Let's list some of the regulatory burdens which could be lifted post-Brexit:

- Overly complex point of sale disclosure requirements which deter some potential retail customers from investing, e.g. 200+ page prospectuses for IPOs, KIDs / KIIDs for investing in funds, ETFs etc.;
- Costs and charges disclosure is now incredibly detailed and complicated (particularly as a result of the MiFID 2 requirements);

- This is exacerbated by the ongoing post-sale reporting requirements where, again, there is a requirement now to provide incredibly detailed costs and charges information;

- Complicated "know your customer" identification requirements even for relatively small levels of trade;
- Prospectus Directive regulation which has resulted in new companies coming to market choosing to place their shares directly with institutions, thus denying individuals the opportunity to access the shares at issue: a key driver of individual share ownership.

There are also impacts which weigh heavily on retail investment businesses' efficiency, and on competition within the industry:

- The huge cost to firms of complying with this regulation which is, of course, passed on to their customers – smaller firms struggle with this, and it has the effect of limiting competition;

- A difficult environment for firms in the ability to transfer books of business, even where it is proven to be in the interests of customers.

Meanwhile new regulation is almost always reactive - shutting the stable door after the horse has bolted - thus placing a deadweight on the industry to comply while allowing miscreants to escape the consequences of their misdeeds.

Financial service regulation has three key objectives: to protect customers, to protect and enhance the integrity of the UK financial system, and to promote healthy competition between financial services providers in the interests of those customers. As Mark Carney proposes, we should use the opportunity of Brexit to focus on delivering these, by setting retail investment free of EU Directives which impose such a burden while missing the mark.

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