

## LIBA'S 2005 ANNUAL REPORT

### STATEMENT BY THE CHAIRMAN

The last year has been marked, again, by noteworthy events and achievements. It has also been a year in which we devoted exceptional efforts to processes of various kinds; and we continued to develop important relationships, and innovative strategies. Our Annual Report describes them fully, so I only comment selectively here.

#### Events and achievements

In the Spring of 2003, LIBA's membership was 40; in 2004 47; and at the time of writing the figure is 55. The enthusiastic support of our growing membership is instrumental both in allowing us to broaden the range of our work and to raise its quality. To sustain this admirable development and to learn first hand about your wishes and needs, I have embarked on a programme of visits to Members with our new Director General, Jonathan Taylor.

In last year's Statement, I announced an innovative agreement to collaborate systematically with the Swedish Securities Dealers Association (SSDA) in international policy work. Both sides have found the collaboration very fruitful; and I am delighted that it has been extended to embrace the Finnish Association of Securities Dealers (FASD). SSDA are exploring with other Nordic & Baltic trade associations the possibility of their joining this venture.

In February 2005, we and five other European trade associations published a set of principles to protect user interests in the event of corporate events involving Stock Exchanges and post-trade infrastructure organisations. In the following months we made substantial submissions to the Office of Fair Trading (OFT) and the Competition Commission (CC) in the UK about the possible LSE mergers with Deutsche Börse and Euronext. We stressed how important it was both to safeguard competition and user interests generally and to prevent the consolidation of vertically integrated silos in trading and post-trading activities. Both bodies strongly supported these principles in their reports on the two proposed mergers.

A year and two weeks later on 20th February 2006, we published a further position paper with our French equivalent (AFEI) - with the support of our fellow associations - in which we responded to the important call to market users from Commissioner McCreevy of 13th September 2005. In that speech he called on market users to establish a clear position on how to move forward the development of clearing and settlement in Europe. There is little doubt that the initiatives we have developed with our fellow European associations are benefiting us all.

Many other achievements have been more narrow and focused, though no less important in their way for that. A striking example was the proposal in the EU's 8th Company Law Directive requiring the yearly publication of a statutory audit for all EU-listed Securities. This proposal threatened to be so costly and pointless for Special Purpose Vehicles (SPVs) used for securitisation as to do major damage to their economics. Together with the International Capital Market Association (ICMA) we persuaded DG Market and the European Parliament to exempt such SPVs from this requirement.

Another example was our response to a "clarification" issued by the Irish Revenue which would have had the effect of retrospectively imposing stamp duty for market makers on Contracts For Differences (CFDs) on Irish securities. This could have had a significant impact on the liquidity and efficiency of the Irish market, particularly in relation to the hedging of these instruments, which are a major business of our Members, both in London and Dublin. Working extremely quickly and effectively with the Irish Stock Exchange, and with vigorous support from our Tax Committee, we were able to persuade the Irish authorities that the measure should be "withdrawn and reconsidered", all this within less than a week.

#### Processes and continuing work

In much of what we do, though, there are no direct measures of effectiveness or success. The engagement with policy work of LIBA staff and members of our Committees and Working Groups involves consultations, revisions, new texts and round upon round of meetings and negotiations with the Treasury, European Commission, European Parliament, CESR or CEBS, other associations at home or abroad and, increasingly, non-EU bodies such as the Basel Committee, FATF or OECD.

#### *MiFID*

Our work on MiFID - the revision of ISD - began over five years ago. Our work with other associations, and the extensive input from Member firms, has contributed significantly to a more workable MiFID than market participants originally feared. It is important now to follow these improvements through by ensuring a well-balanced transposition of the EU legislation into national rules. Responding to our warnings about the dangers of hurrying the implementation of such complex legislative change, the Commission and other institutions have wisely extended the original, impractical, April 2006 deadline for bringing MiFID into effect. But even now MiFID's

rules are not firmly established. So it is still not possible to tell precisely what implementation will require of our Members, even though the implementation deadlines in 2007 are again becoming frighteningly close. We continue to play a central role in arguing for a more rational timetable, taking account of the IT and systems aspects of this demanding venture.

### *Capital*

Capital adequacy has also been a major activity for over five years. A crucial task was the completion of the Trading Book Review consultation with the Basel Committee and IOSCO in the Summer of 2005, in which we worked in close co-operation with five other associations. Despite a very short timescale, the review was broadly successful and, as important, was in time to be incorporated in the EU Directive which was adopted in October 2005. Agreement on this Directive was achieved unusually quickly and as a single package deal. In achieving that agreement, the European Parliament played a central role - and LIBA/ISDA in turn played a very active part in briefing MEPs. Such processes of "co-decision", involving the Commission, Council of Ministers and Parliament, are here to stay. Trade associations will have to be prepared to devote material efforts to the briefing and diplomacy this necessitates if they want their voices to be heard. It is neither simple nor cheap.

2005 also saw the Committee of European Banking Supervisors (CEBS) in action in earnest. Its eight consultations have opened up debate, all but simultaneously, on a wide range of basic themes. In that context we are underlining how vital it is to recognise the fundamental differences between investment firms and banks, and to accommodate the needs of international business outside the EU.

### *Listed Companies and Company Law*

Corporate Finance and Primary Markets are also going through a hectic period of policy and regulatory change. As the new UK Listing Authority regime fell into place last summer, attention shifted to a series of consultations on the EU Takeovers and Transparency Directives; and at home, to the consequent changes in the Takeover Panel and Code. London's strengths owe much to the independence, flexibility and decisiveness of the Panel. So we have been striving to preserve these qualities and to avoid bureaucracy.

The Takeover Directive will make the Panel a statutory body, but with its flexibility and independence intact. However because of the Human Rights Act, those leading corporate advisers who represent parties before the Hearings Committee will in practice no longer be able to be a member of the Panel's Code Committee or Hearings Committee. This loss of expert participation on the Takeover Panel will need to be made good, particularly in the Code Committee. These changes bring to a climax two very hectic years of regulatory change. In their aftermath, we will be watching with particular interest how the Panel adopts the principles of good regulation. We welcome Mark Warham's appointment as Director General at this challenging time and we thank his predecessor, Richard Murley, for his major contribution to the Panel's work.

In addition, the Company Law Reform Bill has been proceeding through Parliament; and this has raised important issues about the liability of auditors and other professional advisers, which have not yet been answered fully or entirely satisfactorily.

### *Joint Money Laundering Steering Group (JMLSG) Guidance*

During the year there have been particularly important developments on the anti-money laundering front; one of the least glamorous - but commercially vital - tasks our association undertakes. The procedures to be adopted by financial markets and professionals to prevent money laundering were first institutionalised by a group of associations in the last decade. They were being revised when the World Trade Center attacks underlined the urgency of reforming them, in a way which was both adapted to today's market practices, as unbureaucratic as possible, and susceptible of timely amendment. Over a period of four years, LIBA has played a major role, together with other fellow associations which together constitute the JMLSG, in preparing the completely revised Guidance which was finally endorsed by the Chancellor in February 2006. The new format - employing generic guidance applicable to all, combined with specialised guidance appropriate to each sector - will make it much more user-friendly. The procedure employed in producing this guidance - with trade association staff and experienced executives as authors, rather than FSA or Treasury officials - could and should be used much more widely. As Chairman of your Association I am delighted and proud of what we have achieved but - an equally important point and a further reason for drawing attention to the guidance here - is that day in and day out all our Member firms should benefit from a much less onerous and more effective set of procedures.

### **Strategic issues: Better Regulation**

Our positive experience with the JMLSG illustrates tellingly how to advance the "Better Regulation" agenda with its emphasis on less, and principles-based, regulation. I have continued to make this a major priority, not just in my work for LIBA, but also as a member of the FSA's Practitioner Panel. In this we are not swimming against the tide, but are working in harmony with the evolving philosophy of the FSA and with the valuable principles and commitments of DG Market's White Paper on Financial Services Policy 2005-10. However there is much to be done to make a reality of this revolution. At this point, there are four issues to note: **industry guidance** is vital; such guidance is of uncertain value without **endorsement** by the authorities; Better Regulation calls for **wise enforcement**; and it must rest on a foundation of **sound research**, which needs to be regularly renewed.

### *Guidance*

Even if the regulatory authorities retreat, wisely, to the higher ground of timeless principles, practitioners still need to know *in detail* what is permitted. Sometimes detailed guidance on the interpretation of the principles can only or best be provided from the official side. However, in other cases the need for flexibility and market knowledge means that market practitioners are best placed to provide it. In that case, while such guidance is not mandatory, it establishes safe harbours. In other words adherence to it is sufficient, but not necessary, to be deemed to comply. LIBA has, of course, already produced such guidance with other associations not only for Money Laundering, but also for Analysts' Research and disclosure of Broking Commission.

### *Recognition and Endorsement*

If market participants are to be able to rely on such guidance, it must be given *some* kind of recognition by an appropriate public body, such as the FSA, Treasury or European Commission. As I explained in my statement to you last year, the FSA and Treasury have still to give full effect to this requirement, even if the need for it is now pretty generally accepted in the UK. So we shall continue to press them. If agreement cannot be reached on a procedure on which you and your staff can rely to signpost what you can safely do, the Better Regulation initiative will fall far short of its potential.

### *Enforcement*

The periodic call from some in the markets for more detail - the antithesis of principles-based regulation - is driven in large part by the fear of arbitrary and excessively strict enforcement. LIBA Members therefore welcomed the FSA's Enforcement Review. In 2005, we participated actively in the work of the City Liaison Group in preparing a submission on the changes needed to the FSA's enforcement procedures. We were delighted that the FSA accepted the great majority of our recommendations and have welcomed the reformed Regulatory Decisions Committee (RDC). However these are early days. We shall need to watch developments closely for some time to ensure the reforms have the effects intended. The success of the new regime will be very sensitive to wise selection of cases, intelligent encouragement of self-reporting, and consistency of purpose. Together they can create the sustained sense of fairness which is essential, but which has yet to be established.

### *Research*

Last and slightly separately comes the issue of research and monitoring. The FSA is committed to following an admirable catechism when deciding whether and how to regulate. Essential at the outset is studying the market "problem" in question to establish whether there is any material failure and, if so, whether regulatory action might be the best way to deal with it. However, practice sometimes falls short of commitment, for example because of *force majeure*, such as the impact of impossible EU timetables; or on other occasions because the authorities lack the money, staff, skill or interest. If so, there is a strong case for market participants to do the necessary work themselves, or jointly with the FSA and other relevant regulators. On other occasions the research required may better be undertaken by several groups of market participants. Both cases call for a kind of initiative for which trade associations are not normally prepared, but now need to be.

In this spirit, LIBA, ICMA, the Association of British Insurers, the Investment Management Association, the European High Yield Association, and the European Primary Dealers' Association, (with welcome financial support from the Corporation of London) have jointly commissioned distinguished academics to undertake independent research into European bond markets. This cross-market project will be used to inform the associations' contributions to the European Commission's review of the possible extension of the scope of the MiFID transparency provisions for equities trading to markets other than equities, in particular to bonds. This project has been welcomed by both the FSA and Commission's DG Market, and we will publish the results for wider debate shortly. If we want Better Regulation, more such industry-led research projects may be essential - particularly when the European authorities are contemplating controversial regulatory initiatives.

### *Monitoring*

A second aspect is the importance of retrospectively monitoring the matters being regulated and the impact of the policies applied to them. The FSA has, uniquely, and much to its credit, undertaken to do this. Adoption of such procedures would self-evidently be invaluable, particularly if it could be developed into a regular audit cycle of the whole *corpus* of regulation.

Its value could extend further still. Firms and trade associations are periodically invited - sometimes challenged and, on the face of it, reasonably - to identify opportunities for deregulation. If we fail to respond we can be reproached for not being serious about the problems of excessive regulation of which we complain, often rather vociferously. When replying to this innocent question, however, even a large firm or trade association often possesses too little information to be able to reply authoritatively. The best and, often, only answer is that the *authorities* themselves should pursue a regular rolling programme of monitoring and research into the impact, costs and benefit of their regulatory apparatus. This might be structured to cover each major bloc of regulations with a certain frequency. Needless to say, once money and resources are sunk in implementing a new regulation, unwinding it is considerably more expensive than not introducing unnecessary measures in the first place.

These four issues - **industry guidance, properly endorsed, supporting well researched regulation, wisely enforced** - are of fundamental importance. We have played a leading role in promoting this philosophy in the UK, within Europe and elsewhere. Our next step is to submit concrete proposals to the FSA to continue this important debate, which they have done so much to open up.

### **The FSA and HM Treasury**

#### ***The FSA***

As Members will be aware, the FSA has continued to pursue a very ambitious agenda. Last year I welcomed its new philosophy. This year I should like to welcome the impact of its new structure, with its clearer focus on true wholesale issues; and the promise of benefits to come from the wider and more systematic application of its risk-based approach. Our close and productive relationships on many fronts have been strengthened by new arrangements for consulting Senior Practitioners and trade associations, of which LIBA's Director General is an *ex officio* member.

As I write, we look forward to the modified supervisory process known as Arrow 2 which is now being introduced; and to the more flexible approach to capital adequacy for smaller firms which is to come soon. Another important project has been the review of the financing of the Financial Services Compensation Scheme (FSCS). This is one of a succession of debates in which we have to be exceptionally vigilant to defend LIBA Members against proposals that they should contribute from their wholesale activities to the financing of compensation for failures in the retail area, for example IFAs. We have also followed carefully the proposals to deregulate Training and Competence. Here, while supporting the thrust of many of the changes envisaged, we have fought hard to retain a register of approved persons which includes individuals who only deal with non-private clients. A comprehensive register is an asset to the whole market. We must take care not to remove the existing structure without putting something more appropriate in its place. There has also been a series of important consultations and statements, formal and informal on hedge funds. These have been marked by a degree of restraint and good sense, which contrasts very favourably with the near-hysteria which this subject so often provoked in the past.

#### ***HM Treasury***

The Treasury has continued to collaborate very closely with our Members and staff on major issues such as MiFID and capital adequacy, and the relationship is one of true partnership. At the same time, the Chancellor and his team have taken important initiatives to recognise the importance of and strengthen relationships with the City, which we welcome. However, there is no doubt that the department's financial services team is very stretched: it must be properly resourced if it is to fulfil the important responsibilities placed upon it.

### **International**

Our relationships with securities associations in other countries continue to flourish and develop: within Europe, particularly with Scandinavia, France, Italy, Germany and Holland; and outside it with the members of the International Council of Securities Associations (ICSA), to which we and others attach growing importance. We have been particularly pleased that ICSA has established an innovative working relationship with IOSCO, to which we have made a significant contribution.

### **Personnel**

Sadly, David Verey has resigned from the Chairman's Committee and the FSA Practitioner Panel after three years in which he gave much invaluable advice. Happily, David's successor on the Practitioner Panel, Colin Keogh of Close Brothers, has agreed to take his place on our Committee.

Within LIBA itself, we were sad to lose Jane Lowe, but delighted to welcome in her place Samantha Barrass, who joins us with a wide range of experience in ICMA, the FSA and regulatory policy-making. We were also particularly fortunate that our first director seconded from the SSSA, Lars Nordström, has been able to contribute so much so quickly to the work of both associations. While he has concentrated particularly on MiFID, he has done much to establish a general *modus operandi* which will be of enduring value to all our future collaborative work.

Lastly but by no means least, after six years of flat out work, Adam Ridley has stepped down from being the Director General of LIBA. I do not propose to go over what has already been covered; but I would like to take this opportunity to thank him for his focus, judgement and boundless energy, which have helped us to establish the Association as a thought and policy leader for the industry, both nationally and, increasingly, internationally. I know he will leave the Association in good hands.

**Alan Yarrow**  
**Chairman**

May 2006