Crisil
Coalition
Greenwich

For Regulators, Intentions Don't Equal Outcomes

November 18, 2014

I'm not a great fan of regulation for regulation's sake. While this is too strong and cursory a judgment on what has been happening in the US and Europe for the past few years, some suggested regulatory changes make you wonder.

For instance, recent proposals from European Securities and Markets Authority (ESMA) and the U.K.-based Financial Conduct Authority (FCA) are of particular concern. While the regulations being introduced aim to protect investors by shining a light on the fees paid by asset management for research, the abolition of 'soft dollars' is likely to have the opposite effect of that intended. Prices for asset management firms will rise and the cost will surely be passed on to the individual investor. And furthermore, it is not clear the problem the regulators are trying to solve is in fact a problem.

It's similar to the rules around mandatory electronic trading of over-the-counter derivatives in the U.S. The Dodd-Frank Act was meant to open up the playing field, introduce competition and deliver a more transparent, centralized marketplace for investors. Instead, Greenwich Associates research has shown the trading flows are concentrating even further through top dealers while liquidity is fragmenting into regional pockets.

Back to equities. While the growth in e-trading in the European equity markets has lagged behind the U.S., the tide is turning with investors expecting to execute 37% of their trading volume via electronic channels by 2017. This is driving down execution costs and sapping commissions in the process. Best execution and algorithmic trading in the equities markets are also benefiting investors in the short-term, but there is a real danger that constrained revenue from cash equities will continue to hobble brokers' efforts to enhance their services. Long-term this is not good for the industry.

Increased regulatory scrutiny from ESMA and the FCA is compounding the negative effects of e-trading. In late 2013, ESMA led efforts to place caps on trading in dark pools in single venues, and across EU exchanges in hopes of fostering more transparency in the European markets. 58% of traders participating in a Greenwich Associates survey strongly oppose the dark pool trading-cap rules, suggesting that the caps will reduce efficiency and liquidity – leading to higher costs.

In addition to the tightening of trading regulations, the FCA, and subsequently ESMA, is aiming to delineate how asset managers can leverage client funds. In a consultation paper from November 2013, with clarifications from May 2014, the FCA outlined the need for the buy-side to use client funds for substantive research – buy/sell/hold recommendations and projections based on analytical data. Although this may seem to best serve the managers' clients, the reality is that equity research and advisory services are crucial to maintaining market equilibrium.

The latest Greenwich Associates European Equity Investors research shows that 54% of the commissions wallet, an estimated €1.47 billion, is allocated to research and advisory services. With commissions suppressed by dark pool trading caps and the growing phases of e-trading, the buy-side is left with few options to aggregate the necessary market intelligence:

- Take on these costs directly, lowering profitability
- Bring research capabilities in-house, increasing costs
- Be priced out of the market by competitors willing to meet increasing sell-side price tags

Any of these options will inevitably affect the end investors. Whether their fees rise to new heights, returns suffer from lack of information, or they are phased out of the market, the goals of the FCA and ESMA won't be met. Investors will suffer, while the buy-side and sell-side scramble to adjust to a new environment. Regulators need to consider the holistic impact of action, before disrupting the markets with the next big splash.

---

www.greenwich.com | ContactUs@greenwich.com

Coalition Greenwich, a division of CRISIL, an S&P Global Company, is a leading global provider of strategic benchmarking, analytics and insights to the financial services industry.

We specialize in providing unique, high-value and actionable information to help our clients improve their business performance.

Our suite of analytics and insights encompass all key performance metrics and drivers: market share, revenue performance, client relationship share and quality, operational excellence, return on equity, behavioral drivers, and industry evolution.

About CRISIL

CRISIL is a leading, agile and innovative global analytics company driven by its mission of making markets function better. It is majority owned by S&P Global Inc., a leading provider of transparent and independent ratings, benchmarks, analytics, and data to the capital and commodity markets worldwide.

CRISIL is India's foremost provider of ratings, data, research, analytics, and solutions with a strong record of growth, culture of innovation, and global footprint.

It has delivered independent opinions, actionable insights and efficient solutions to over 100,000 customers through businesses that operate from India, the U.S., the U.K., Argentina, Poland, China, Hong Kong, and Singapore.

For more information, visit www.crisil.com

Disclaimer and Copyright

This Document is prepared by Crisil Coalition Greenwich, which is a part of Crisil Ltd, a company of S&P Global. All rights reserved. This Document may contain analysis of commercial data relating to revenues,

productivity and headcount of financial services organisations (together with any other commercial information set out in the Document). The Document may also include statements, estimates and projections with respect to the anticipated future performance of certain companies and as to the market for those companies' products and services.

The Document does not constitute (or purport to constitute) an accurate or complete representation of past or future activities of the businesses or companies considered in it but rather is designed to only highlight the trends. This Document is not (and does not purport to be) a comprehensive Document on the financial state of any business or company. The Document represents the views of Crisil Coalition Greenwich as on the date of the Document and Crisil Coalition Greenwich has no obligation to update or change it in the light of new or additional information or changed circumstances after submission of the Document.

This Document is not (and does not purport to be) a credit assessment or investment advice and should not form basis of any lending, investment or credit decision. This Document does not constitute nor form part of an offer or invitation to subscribe for, underwrite or purchase securities in any company. Nor should this Document, or any part of it, form the basis to be relied upon in any way in connection with any contract relating to any securities. The Document is not an investment analysis or research and is not subject to regulatory or legal obligations on the production of, or content of, investment analysis or research.

The data contained in the Document is based upon a particular bank's scope, which reflects a bank's data submission, business structure, and sales revenue Reporting methodology. As a result, any data contained in the Document may not be directly comparable to data presented to another bank. For franchise benchmarking, Crisil Coalition Greenwich has implemented equal ranking logic on aggregate results i.e., when sales revenues are within 5% of at least one competitor ahead, a tie is shown and designated by = (where actual ranks are shown). Entity level data has no equal ranking logic implemented and therefore, on occasion, the differences between rank bands can be very close mathematically.

The data in this Document may reflect the views reported to Crisil Coalition Greenwich by the research participants. Interviewees may be asked about their use of and demand for financial products and services and about investment practices in relevant financial markets. Crisil Coalition Greenwich compiles the data received, conducts statistical analysis and reviews for presentation purposes to produce the final results.

THE DOCUMENT IS COMPILED FROM SOURCES CRISIL COALITION GREENWICH BELIEVES TO BE RELIABLE. CRISIL COALITION GREENWICH DISCLAIMS ALL REPRESENTATIONS OR WARRANTIES, EXPRESSED OR IMPLIED, WITH RESPECT TO THIS DOCUMENT, INCLUDING AS TO THE VALIDITY, ACCURACY, REASONABLENESS OR COMPLETENESS OF THE INFORMATION, STATEMENTS, ASSESSMENTS, ESTIMATES AND PROJECTIONS, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE ARISING OUT OF THE USE OF ALL OR ANY OF THIS DOCUMENT. CRISIL COALITION GREENWICH ACCEPTS NO LIABILITY WHATSOEVER FOR ANY DIRECT, INDIRECT OR CONSEQUENTIAL LOSS OR DAMAGE OF ANY KIND ARISING OUT OF THE USE OF ALL OR ANY OF THIS DOCUMENT.

Crisil Coalition Greenwich is a part of Crisil Ltd., an S&P Global company. ©2025 Crisil Ltd. All rights reserved.