SYMPOSIUM ON BUILDING THE
FINANCIAL SYSTEM OF THE 21ST CENTURY:
AN AGENDA FOR EUROPE AND THE UNITED STATES
The Weill Center, 188 King Street, Armonk, New York
APRIL 11-13, 2018

AGENDA

Wednesday, April 11

5:35 p.m. & 5:50 p.m. *Ritz Carlton Guests – Bus to the Weill Center; meet in front of the Ritz Carlton*

6:00-6:40 p.m. **COCKTAIL RECEPTION** *Main Lobby*

6:40-6:45 p.m. **GREETINGS** *Dining Room*

- Hal Scott, Nomura Professor and Director, Program on International Financial Systems, Harvard Law School

6:50-8:00 p.m. **KEYNOTE ADDRESS** *Dining Room*

- Andreas Dombret, Member of the Executive Board, Deutsche Bundesbank
- Hester Peirce, Commissioner, U.S. Securities and Exchange Commission

Introduced by: Hal S. Scott, Nomura Professor and Director, PIFS, Harvard Law School

8:00-9:30 p.m. **DINNER** *Dining Room*

9:30-10:30 p.m. **AFTER DINNER COCKTAILS** *Main Lobby*

9:35 P.M. 10:05 P.M, & 10:30 P.M. *Ritz Carlton Guests – Bus back to hotel; meet in Main Lobby of Weill*

Thursday, April 12

7:15 a.m. & 7:30 a.m. *Ritz Carlton Guests – Bus to the Weill Center- Meet in front of Ritz Carlton Hotel*

7:30-8:15 a.m. **BREAKFAST** *Dining Room*

8:20-8:50 a.m. **KEYNOTE ADDRESS** *Dining Room*

- David Malpass, Under Secretary for International Affairs, U.S. Department of the Treasury

8:50-9:20 a.m. **PANEL SESSION** *Room H*

The Future of Global Regulatory Bodies: BIS, IOSCO, and FSB

- Greg Baer, President, The Clearing House Association
- Barbara Novick, Vice Chairman, BlackRock

9:20-10:40 a.m. **SMALL GROUP SESSIONS**

Group	Room	Facilitator	Reporter
1	Room H	Roger Cogan	Bill Grimes
2	Room F	Alexis Rosenblum	Simon Gleeson
3	Room J	Chris Finger	Eugenio Gomez-Tarragona
4	Room A	Bouke dr Vries	Katalin Dobranszky-Bartus
5	Room B	David Freeman	Bart Joosen

10:40-10:55 a.m. **REFRESHMENT BREAK**

10:55-11:25 a.m. **PANEL SESSION** *Room H*

Impact of Brexit on U.S. – EU Financial Relationship

- Michael Percival, Head of EMEA Regulatory Affairs, JP Morgan
- Philip Evans, Director, Financial Policy, Bank of England
- Jonathan Jachym, U.S. Country Head & Head of Government Relations and Regulatory Strategy, London Stock Exchange Group

11:25-12:50 p.m. **SMALL GROUP SESSIONS**

Group	Room	Facilitator	Reporter
1	Room H	Jon Whitehouse	Bill Grimes
2	Room F	Nick Collier	Simon Gleeson
3	Room J	Mark Schuerman	Eugenio Gomez-Tarragona
4	Room A	John Phipps	Katalin Dobranszky-Bartus
5	Room B	Alan Houmann	Bart Joosen

12:50-1:45 p.m. **LUNCH AND KEYNOTE ADDRESS** *Dining Room*

- James Sullivan, Deputy Assistant Secretary for Services, International Trade Administration, U.S. Department of Commerce

1:45-3:10 p.m. **PLENARY SESSION** *Room H*

MIFID II Trading and Market Structure

- Jakub Michalik, International Affairs Officer, European Securities and Markets Authority (ESMA)
- Virginie Saade, Director of Government and Regulatory Policy for Europe, Citadel
- Brett Redfearn, Director, Division of Trading and Markets, Securities and Exchange Commission
- Michael Masone, Director & Head of Americas Equities Market Structure, Citigroup
- Moderator: James Angel, Associate Professor, McDonough School of Business, Georgetown University

3:15 p.m. *Ritz Carlton Guests – Bus back to hotel; meet in Weill Main Lobby*

3:15-6:10 p.m. **REPORTERS MEETING/FREE TIME** *Room F*

5:55 p.m. & 6:05 p.m. *Ritz Carlton Guests – Bus to the Weill Center; meet in front of the Ritz Carlton Hotel*

6:15-7:00 p.m. **COCKTAIL RECEPTION** *Main Lobby*

7:00-9:00 p.m. **DINNER AND KETNOTE ADDRESS** *Dining Room*

- Willem Buiter, Special Economic Advisor, Citigroup

9:00-10:00 p.m. **AFTER DINNER COCKTAILS** *Main Lobby*

9:00 P.M., 9:30 P.M. & 10:00 P.M. *Ritz Carlton Guests – Bus back to hotel; meet in Main Lobby of Weill*

Friday, April 13

7:15 a.m. & 7:30 a.m. *Ritz Carlton Guests – Bus to the Weill Center- Meet in front of Ritz Carlton with your luggage*

7:30-8:15 a.m. **BREAKFAST** *Dining Room*

8:20-9:00 a.m. **KEYNOTE ADDRESS** *Dining Room*

- Tilman Lueder, Head of The Securities Markets Unit, European Commission (via live interactive video conference)

9:05-10:05 a.m. **PRESENTATION & DISCUSSION** *Room H*

The Future of Global Regulatory Bodies: BIS, IOSCO, and FSB

- Adam Wand, Head, Global Public Policy, Visa
- Hal Scott, Nomura Professor and Director, Program on International Financial Systems, Harvard Law School

10:05-10:15 a.m. **REFRESHMENT BREAK**

10:20-11:15 a.m. **PRESENTATION & DISCUSSION** *Room H*

Impact of Brexit on U.S. – EU Financial Relationship

- Chris Bates, Partner, Clifford Chance
- Sven Kasper, Head of Government and Regulatory Affairs EMEA, State Street
- Larry Sobin, Director, Promontory Financial Group

11:15-12:25 p.m. **PLENARY SESSION** *Room H*

Index Investing Versus Active Management

- Brian Smith, Director, Office of Capital Markets, U.S. Department of the Treasury
- Jordan Alexiev, Team Leader, Asset Allocation Research, Fidelity Investments
- Rodney Comegys, Risk Management, Vanguard
- Craig Lazzara, Managing Director and Global Head of Index Investment Strategy, S&P Dow Jones Indices
- Moderator: Rory Callagy, Senior Vice President, Financial Institutions Group, Moody's

12:25-1:00 p.m. **CLOSING BUFFET LUNCH** *Dining Room*

1:05 P.M. *Buses from the Weill Center to JFK and Grand Central Station*

The Program on International Financial Systems

Symposium on Building the Financial System of the 21st Century:

An Agenda for Europe and the United States

Armonk, New York | April 11-13, 2018

Final Report

2018 SYMPOSIUM ON BUILDING THE FINANCIAL SYSTEM OF THE 21ST CENTURY: AN AGENDA FOR EUROPE AND THE UNITED STATES

The 18th Europe-US Symposium of Program on International Financial Systems was held on April 11-13, 2018 at the Weill Center in Armonk, New York. Participants discussed the future of global financial regulatory bodies including the Bank for International Settlements (BIS), International Organization of Securities Commissions (IOSCO), and Financial Stability Board (FSB); the impact of Brexit on U.S.-EU-UK financial relations; the impact of the EU's Markets in Financial Instruments Directive (MiFID) II on market structure and trading; and index investing versus active management.

Session 1: The Future of Global Financial Regulatory Bodies

In Session 1, participants discussed the future of global financial regulatory bodies, including the BIS, IOSCO, and FSB. There was considerable discussion about whether the global regulatory bodies had become too intrusive on national prerogatives in their quest to improve global regulatory consistency and financial stability. Participants debated the causes and effects of "mission creep" and discussed whether there should be changes in the missions and governance of those institutions. There was also discussion about what means should be used to improve global regulatory and supervisory cooperation.

Roles

Participants identified several roles that global financial regulatory bodies had played, including coordination, promotion of common data standards and information, trust-building, and policy formulation. While the first three roles were widely supported by participants, the role of global regulatory bodies in policy formulation was more controversial. It was also noted that global regulatory bodies varied considerably, ranging from loose discussion forums to well-articulated bureaucracies with their own missions, budgets, and procedures.

Coordination

Coordination was seen by many participants as the core function of global regulatory bodies. Given the differences among national legal, regulatory, and supervisory systems, it was understood that transnational financial institutions and cross-border transactions would inevitably encounter situations where compliance with the rules of multiple jurisdictions would be difficult—either because of the costs of compliance or the need to comply with contradictory requirements. Moreover, a number of participants noted differing rules and standards could easily lead to an uneven playing field.

While coordination was uncontroversial as a principle, participants differed in their understanding of where the boundary lay between coordination and intervention. There was widespread agreement on some of the types of coordination in which global financial regulatory bodies were engaged. One of these was technical coordination. Participants agreed that it was important that regulators and supervisors had a common understanding of key concepts and means of measurement, as for example with the work of the Basel Committee in defining capital. Technical cooperation could also help to identify points in which regulations or supervisory principles differed across jurisdictions, and to try to determine the impact of such differences. And regulators and supervisors could learn from the experiences of their counterparts in assessing financial institutions' behaviors and risk profiles.

There was more disagreement about the appropriate roles of global bodies in harmonizing regulations. Some argued that harmonization was one of the primary goals of global cooperation, both to level the playing field for financial institutions across jurisdictions and to reduce the difficulties and costs for transnational financial institutions having to obey differing rules across multiple jurisdictions. Others countered that global regulatory bodies lacked the legitimacy to seek to impose changes in national regulations. They made the point that different jurisdictions

might choose different types and levels of regulation for a variety of reasons, including financial structure, legal system, or political preferences, and argued that it was not the job of global regulatory bodies to try to force uniformity. Rather, they argued, in a world of differences, regulatory coordination was essential mostly in order to ensure that regulators understood the differences across jurisdictions and therefore had the basis to negotiate rules of engagement. Moreover, it was argued that some coordination issues were best managed bilaterally rather than multilaterally. Thus, a number of these participants argued that the goal of harmonization should be jettisoned in favor of equivalence determinations or memorandums of understanding on how to address differences across jurisdictions. Some of the particulars of that sort of regulatory cooperation for Europe and the U.S. were addressed at length in Sessions 2 and 3.

Supervisory cooperation was also seen by participants as a useful role for global regulatory bodies. Several participants saw the main utility of IOSCO, for example, as offering a venue for discussing common challenges of supervision and clarifying principles and procedures for how supervisors could cooperate on concrete tasks. However, they also argued that most concrete supervisory challenges were best addressed not in a multilateral forum, but among just the relevant jurisdictions. Others disagreed, feeling that global regulatory bodies had an important role in devising standards and monitoring the performance of member jurisdictions in meeting them.

Information

Many participants felt that global regulatory bodies had an important role to play in terms of information. For regulators dealing with cross-border issues, access to comparable and high-quality information was seen to be both extremely important and inherently difficult to obtain without common standards and protocols for exchange. Global regulatory bodies offered the promise of providing common knowledge that national regulators and supervisors could use.

But global regulatory bodies vary considerably with regard to their capabilities and functions with regard to information. Some, such as the Basel Committee, provide important services to financial institutions and national regulators by collecting and disseminating data as well as providing research and analysis for member states. Moreover, they contribute to monitoring and assessment of jurisdictions' compliance with supervisory and regulatory requirements.

Other global regulatory bodies, such as IOSCO, lack the resources, and thus the expertise, to collect, analyze, and disseminate data. But participants argued that they too could provide essential support in creating a body of common knowledge for policymaking. At a minimum, global regulatory bodies were seen as venues for information sharing and comparison.

A related function was the establishment of data standards for members. For example, it was noted that trade repositories in the U.S. and EU faced different standards for the types and formatting of trading data, although the data needs of their supervisors were presumably identical or at least highly similar. Standardization of trading data would benefit market participants and platforms by reducing their regulatory burden without reducing the informational content. Regulators and supervisors would benefit from having consistent, comparable data from multiple jurisdictions that could be used to evaluate the effects of policies and practices. A number of participants argued that this was the sort of task in which IOSCO should play a key role

In addition, several participants emphasized the importance of standardization of definitions and measurement protocols. Participants noted that the lack of common definitions hampered effective policy learning and coordination. This was seen by many participants as particularly important in emerging areas of financial practice and regulation such as fintech, but it was also noted that regulators in different jurisdictions often had differing definitions for widely-used concepts such as shadow banking or high-frequency trading. Similarly, participants noted that discussions of core international regulatory concepts such as collateral, capital, liquidity, and leverage had benefited considerably from efforts to create a common vocabulary and set of definitions.

Finally, there was some discussion of the roles of global regulatory bodies in research, monitoring, and assessment. In discussing these issues, participants recognized that the capabilities of different global regulatory bodies varied widely. Some, such as the BIS, had significant independent data and research capabilities. More typical were the cases of IOSCO and the FSB, where the work of standard-setting, monitoring, and assessment was done by committees composed of member country regulators. In general, participants approved of global regulatory bodies' roles in research, monitoring, and assessment. There were, however, some concerns expressed that some such bodies had taken their monitoring mandate to too far. In particular, a number of participants criticized the FSB for having gone beyond its remit of monitoring countries' progress toward G20 goals in an effort to become a *de facto* enforcer.

Socialization, Communication, and Trust

Beyond the functional roles already noted, a number of participants made the case that another important role of the global financial regulatory bodies was to build trust among national regulators and supervisors. While less concrete than other roles, it was argued that socialization, communication, and trust-building were very important to the management of the global financial system, particularly in a crisis.

Participants perceived several benefits from communication and socialization. One was simply the utility of understanding what counterparts were doing in other jurisdictions and to understand the reasoning behind their policies, which could contribute to better policy coordination. Also, the process of working together on common projects and working groups could develop norms of cooperation and personal trust that could "lubricate" coordination processes and negotiations. Finally—and for some participants most importantly—it was argued that the experience of cooperating on an ongoing basis would allow for more effective crisis management, as regulators and supervisors would know each other and better understand the regulatory systems and political dynamics of other jurisdictions with which they would have to cooperate. However, some participants emphasized the limits of socialization, communication, and trust-building. While acknowledging their usefulness in situations of common interests, they argued that there were many cases—including in crises—where national interests would diverge, and thus individual relationships and trust were unlikely to make much difference.

Policy Formulation

Finally, there was considerable discussion over whether the global financial regulatory bodies were the proper venue for policy formulation. A number of participants argued that this was an

appropriate function for these bodies, as they offered the opportunity for creating common standards and a level playing field based on the input from a large variety of global actors. Others strongly opposed that conception. They argued that only national governments had the legitimacy to make policy in their jurisdictions, and that the global bodies should confine their role to ensuring accurate communication and providing a venue for managing differences rather than pushing harmonization.

Governance

Participants identified governance of global financial regulatory bodies as linked in important ways to their roles and functions. A number of participants were critical of what they saw as a lack of accountability and transparency in the ways in which they operated.

One of the key issues was the appropriate roles of principals and experts in the business of the global financial regulatory bodies. Some participants argued that these organizations were losing sight of their member-driven character, with unelected technocrats often setting agendas in ways that did not address the main concerns of the elected leadership of national governments. Others disputed this claim. They argued that member governments had consistently set the agendas of global regulatory bodies—particularly in the FSB, whose mission it was to implement the G20 financial regulatory reform agenda. They saw the debate over whether global bodies were "member-driven" as a mislabeling of the real issue, which was that the new U.S. administration did not like the direction that the global bodies were taking, which reflected the priorities of the previous administration and of other countries including many in Europe. In this view, the U.S. call for more attention to the priorities of the member states was more about the types of agenda items that were being pursued than about the process.

Another point of disagreement in the discussion over the role of members was over who constituted a principal. Participants agreed that the secretariats of the global bodies should in general not be driving their agendas. However, there was some question as to the respective roles of national technocrats and the politically-appointed leadership of the national agencies. A number of participants rejected the claim that members were not driving agendas, pointing out that nearly all of the research and discussion in the various workstreams of IOSCO, the Basel Committee, etc. were actually being done by staff of the national regulators. But others felt that only direction from political leadership, not technocrats, could satisfy the need for legitimacy. Otherwise, technocrats might take advantage of their ability to set agendas in international forums to push their own agendas back home. Despite this disagreement, there appeared to be a consensus that workstreams and other activities should be based on clear mandates with which the member-states agreed.

A keyword for many participants was "accountability." Partly, this was about the role of member-states. But many participants also supported the idea of accountability toward a broader range of interested parties, or "stakeholders." They argued that practitioners could offer essential knowledge and perspective that could improve regulation and supervision. Some participants offered what they considered to be good examples of effective communication with practitioners. For example, the BIS's FX Working Group had consulted extensively with financial institutions in revising the FX Global Code. Also, some participants praised IOSCO for holding stakeholders' meetings in conjunction with the principals' meetings.

However, the idea of institutionalizing stakeholder input also raised several questions. First, to which stakeholders should the global financial regulatory bodies be accountable? A number of participants made the case that financial institutions should have a seat at the table when their interests were at stake, but this raised the question of whether other interested parties—perhaps civil society organizations (e.g., Bretton Woods Project) or end-users of financial services (e.g., Council of Institutional Investors)—should be included, and at what point such consultation would become unwieldy. Second, some participants argued that national regulators and supervisors should already be aware of the concerns of their financial institutions and other stakeholders operating in their jurisdictions, and that the proper place for these stakeholders to pitch their cases would be to their home regulators. In response, others argued that, for the cross-border issues on which global bodies like IOSCO focus, lobbying or coordinating with domestic authorities would not be sufficient. Third, what would be the proper mechanisms for accountability to non-state stakeholders? Participants raised a number of possibilities that ranged from informational (e.g., putting out drafts for public comment) to inclusive (e.g., creation of private sector advisory panels, regular meetings with principals or staff).

In general, greater transparency was seen by many participants as a basic precondition for accountability to stakeholders. They noted that for many of the activities of global financial regulatory bodies, there was a notable lack of information available to interested parties. In the FSB, for example, even basic facts about committees and workstreams were unclear, including membership, workplans, and meeting schedules. In a related complaint, a number of participants expressed frustration at the lack of *ex post* assessments by the FSB of the effects of implementation of the G20 financial regulatory agenda.

Finally, participants raised the question of representation in global governance. Several argued that there was a trade-off between country representation and efficiency, and wondered whether some of the global regulatory bodies had too many members. It was suggested, for example, that the membership of the FSB (25 jurisdictions, 4 international financial institutions, and 6 standard-setting bodies) was unwieldy for coming to decisions, and that smaller groups of relevant countries would be better venues for dealing with many issues. Some participants argued that this was particularly true of sophisticated financial markets and products that were based in only a few financial systems. A similar point was made about the Basel Committee—as some participants noted, GSIBs were based in a very small number of jurisdictions (i.e., U.S., EU, UK, Switzerland, Japan, maybe China), so perhaps the core membership should be focused on those regulators . Other participants disagreed, arguing that the legitimacy of global bodies and global standards depended on broad representation. Moreover, they noted, many jurisdictions were affected by the Basel standards even if they were not home to major global financial institutions—either because they had adopted global standards domestically to enhance their international reputations or because some of their banks were doing business in countries such as the U.S. that mandated compliance with them. Additionally, some participants argued that, because some jurisdictions' financial systems were developing rapidly and might soon be important players, they should be involved in setting standards and addressing issues that would soon apply to them.

An additional dimension of the issue of representation was agency representation. Here too, participants saw potential trade-offs between representation and efficiency. In Basel, for example, it was noted that the U.S. was represented by a multitude of agencies, including the

Federal Reserve Board, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, and the New York Fed. While this seemed like a lot of agency representation, the Treasury was not a participant because Basel was formally about banking rules. However, in some ways, Basel could be seen as being more about macroprudential supervision, in which Treasury was a central player. Similarly, the complaint was voiced that market regulators had second-class citizenship at the FSB, which is located and staffed at Basel. Thus, from a representation point of view, there was a case to be made for expanding agency participations. However, looking across all the different global regulatory bodies, many participants argued that the sheer scale of the meeting schedule was too time-consuming for regulatory agencies and that there rather ought to be a winnowing of functions, committees, and workstreams in order to allow for more focus and less wasted time.

Functions and Mission Creep

The volume of activity at the global financial regulatory bodies was a major concern for many participants. The multiplicity of organizations, meetings, workstreams, and reports was seen as exhausting—and in some cases distracting—not only for regulators and supervisors, but also for the financial institutions that were trying to keep track of their activities and provide feedback about reports and proposals.

Looking at the profusion of missions and activities, many participants spoke of "mission creep." Several possible explanations were put forward by participants of what accounted for mission creep in the global financial regulatory bodies. One popular explanation was bureaucratic incentives—i.e., that bureaucrats always have a preference for expanding the scope of their responsibilities. Others argued that the problem was not just that new missions were being added, but also that old ones never ended. Further, some participants felt that it was unfair just to blame bureaucrats, and instead looked to the principals to explain mission creep. They noted that implementation of new global standards was inconsistent and often slow, which extended the lives of some workstreams. Several participants suggested that log-rolling by principals could also account for mission creep, as the cost for a given member-country of putting an item on the agenda might well be supporting another member-country's pet project.

Whatever the causes, many participants argued that it was time to roll back and refocus, while also preserving the positive contributions made by the global financial regulatory bodies. This would address not only the problems of mission creep and consumption of staff resources, but also growing concerns about accountability and sovereignty. Several participants argued that, at a time when globalism was under attack in many countries, it was particularly important to rethink the mandates of the global bodies in order to ensure their legitimacy and efficiency. They made a strong case that both the mandates and the concrete workplans should be decided and affirmed by members.

There was considerable discussion about what that recalibration should entail, with two main proposals. First, many participants argued that global financial regulatory cooperation should move away from trying to revise standards and harmonize regulation across financial systems, which they saw as excessively intrusive. Instead, they proposed that global cooperation should refocus on cross-border issues or on emerging common problems. They pointed to a number of important but as-yet-unresolved cross-border issues in both regulation (e.g., transatlantic trade in

derivatives and use of CCPs, data localization) and supervision (e.g., how to resolve a failed transnational financial institution). Participants also noted a number of emerging common challenges where global cooperation could be important in defining the problems and setting common approaches in order to maximize efficiency. These included cybersecurity, benchmarks (e.g., how to deal with the future of LIBOR), and bondholder rights in resolution and bankruptcy.

The second proposal was based on an assessment that the post-crisis reform agenda had now been mostly implemented. Thus, many participants considered it to be a good time for global regulatory bodies to shift their attention to an assessment of what had been done over the last decade. Participants considered the most important element of that reassessment to be a thorough evaluation of how the vast expansion of new rules and regulations had affected financial stability and economic growth. Based on such an assessment, regulators and supervisors could recalibrate so as to maintain elements that had proved to be useful and to ease or eliminate requirements that had not. At the same time, many participants agreed that it would be helpful to continue to assess the uniformity of application, in order to determine whether there were areas of uneven playing fields or potential areas for renewed financial instability.

Session 2: Impact of Brexit on U.S.–EU–UK Financial Relations

In Session 2, participants discussed the impacts of Brexit on financial relations between the UK and EU and between the U.S. and EU. While recognizing the many uncertainties that remained regarding the terms of Brexit, they zeroed in on equivalence determinations as an issue of central importance to both relationships. Participants also discussed the politics of the UK-EU and U.S.-EU financial relations, including what frameworks would be used to ensure cooperation and coordination in the transatlantic relationship.

How Will the EU Handle Brexit?

Participants discussed at length the likely dimensions of the UK-EU Brexit deal, about which a variety of questions remained unanswered. They considered both economic consequences and political dynamics.

Participants identified several options for post-Brexit UK-EU financial relations. At one end of the spectrum was the inclusion of finance in a comprehensive free trade agreement (FTA) that would ensure the free flow of goods and services between the UK and EU even after Brexit. Participants were generally pessimistic about the prospects that there would be such a formal agreement that would cover all the relevant aspects of financial relations. Although many considered it likely that there would be a financial chapter in a UK-EU FTA, they noted that the financial chapters of existing FTAs were very limited in scope. A second option was negotiated agreements that granted waivers from EU supervision to certain types of transactions or services. This was seen as more likely to address some of the most complex issues of the post-Brexit landscape, although participants felt very uncertain as to which activities might be covered. A third option, which would be functionally (if not procedurally) similar to the second option was a determination by EU authorities that the UK financial regulatory regime was equivalent to that of the EU. The fourth option would be the financial face of a "hard Brexit"—in other words, that the UK would not receive any special dispensation. A final possibility, which some participants saw as the likeliest outcome, was some combination of those options—although how particular transactions and services would be treated was unpredictable.

From an economic perspective, there was broad agreement among participants that the rational outcome would be that the EU would evaluate the UK financial system as being equivalent to that of the EU or that negotiations would lead to mutual recognition. Participants pointed out that the EU had already made equivalence determinations for a number of other financial systems (including that of the U.S.) and had entered into agreements to ensure the continuity of cross-border transactions of many kinds. They also noted that, by any measure, the UK financial regulatory and supervisory system would be equivalent to that of the EU—in fact, it would start out as identical, so equivalence would be an easier case to make than for the U.S. Thus, they saw an equivalence determination as the rational outcome for a law-driven organization such as the EU.

Participants also noted, however, that in the end the decision would be politically driven, as it touched on core aspects of the post-Brexit UK-EU relationship as well as of the EU as an entity.

They identified several political undercurrents to EU decision making on how to handle the financial aspects of Brexit. One of these was resentment of the UK's decision to break away from the EU, which appeared to many participants to lead to a desire to punish the UK by making it harder for UK-based entities to profit from EU financial business. Another political motivation that many participants believed was contributing to a hardline stance on the part of the EU was a desire to prevent future departures by other EU members; by making the consequences of Brexit sufficiently unpleasant, it was argued, the EU could create a precedent whose costs would deter exit. A number of participants argued that a third reason why some EU member-states wanted to take a tough line against the UK was that they hoped to gain competitive advantage for their own financial institutions and markets. For these reasons, a number of participants expected that Brexit would lead to significant disruption in financial relations between the EU and UK.

Others were more optimistic, however. They pointed out that the EU and UK financial systems were so interdependent—with EU economies dependent on London financial markets for many key functions—that the costs of taking a hard line in order to punish the UK might well discourage the EU from doing so in the end. They also noted that, even if the EU wanted to punish the UK, there were many ways of doing so outside of the financial realm, including on trade in goods or other services, immigration, or the financial settlement required by its departure. Both EU and UK negotiators would necessarily be thinking about trade-offs among various sectors and functions, which they felt would likely soften the impact on financial transactions and cooperation.

Whatever the final shape of the agreement, most participants anticipated that there would be differential impacts across sectors and functions. Moreover, there was a consensus that, in order to prevent serious disruptions to financial services, there should be a generous transition period to allow both EU and UK financial institutions to adjust to the new reality. Participants agreed that the length and sequence of that transition would be important.

Participants discussed at some length what UK-EU financial relations would look like after Brexit. The main question was whether the center of EU finance would move from London or stay in place. Many participants agreed that other EU member states were interested in taking business away from the UK. They pointed to efforts by countries including France, Germany, Ireland, and Luxembourg to lure financial institutions to their jurisdictions, as well as moves by some UK and non-EU financial institutions to shift at least parts of their European operations out of the UK and into remaining EU countries.

Many participants argued that, even if the EU were to insist on measures to force more localization, it would be too disruptive to do so quickly, so a long transition period would be in order. Some also made the case that London would be irreplaceable well into future. They noted that most activity under the existing MiFID framework occurred in London, including IPOs and basically all exchange-traded (and bespoke) swaps and derivatives, despite the dispersion of trading platforms. The disruption of trying to change that quickly would be enormous. Moreover, they pointed out that London had not maintained its position as a global center primarily because of EU business or euro-denominated clearing—indeed, it was noted that only about 20% of UK wholesale financial activity was EU-focused. Rather, London had attracted business from around the world due to its efficiency, infrastructure, human capital, high-quality regulation and

supervision, and the attractiveness of English law. They argued that these advantages were unlikely to change, and that it would take many years of accumulation of capabilities for any European financial market center to rival London's global attractiveness. Others were less sanguine, arguing that EU politicians would find the heavy reliance on London to be politically unacceptable.

Some functions were seen as more likely than others to be affected by Brexit. It was argued that two types of UK-based financial services in particular seemed to be at risk. One was euro-denominated clearing. EU authorities had insisted that such clearing needed to be supervised by the EU and ECB, but UK authorities were unwilling to cede supervision of UK-based clearing operations to the EU. Instead, they called for the EU to recognize UK regulation and supervision as equivalent to that of the EU and agree to substituted compliance, as they had in the past done for the U.S. While Eurozone regulators had been publicly adamant that euro clearing in the UK must be subject to supervision by the EU in order to assure Eurozone financial stability, few participants were convinced by that argument. They countered that currency sovereignty could be achieved only by partly closing capital account; indeed, they noted that over 90% of US dollar swaps were traded outside the U.S., with no effect at all on U.S. financial stability. They also pointed out that U.S.-based clearinghouses accounted for twice as much euro clearing of interest rate derivatives as UK-based clearinghouses, and that U.S.-based clearinghouses were not supervised by EU authorities. Thus, many argued that the real EU rationale was not about financial stability, but rather a desire to relocate this important financial service to EU territory as a means of building up continental financial market centers. However, participants expressed serious reservations about the practicality and implications of forcing euro clearing activities into new locations that lacked London's liquidity, infrastructure, and depth of expertise. Indeed, some participants argued that it would be better to allow EU supervision of UK-based clearing than to have to move to inferior alternative locations. This appeared to be unacceptable to UK authorities, however.

Participants identified UK-based asset management for EU clients as another financial function that was potentially imperiled by Brexit. There was considerable confusion about what the end-game was for EU negotiators. Most participants agreed that some core functions of asset management such as trading were unlikely to be affected; rather, they expected that customer-facing functions were the most likely to have to move to EU jurisdictions. But this was not reassuring to a number of participants, who were concerned that the EU might force portfolio managers to move away from the non-EU markets in which they operated, which would significantly disrupt their operations. Certain back-office functions including storage of customer data might also have to be transferred to EU jurisdictions. Thus, these participants argued strongly that the EU's current proposals would be harmful to both asset management firms and their clients.

Brexit Effects on U.S.

Participants discussed at length the likely effects of Brexit on the U.S. While they saw few if any impacts on the financial relationship between the U.S. and UK, they expressed major concerns about how U.S.-EU financial relations would be affected by the way the EU dealt with the UK in and after Brexit.

Participants noted that cross-border business between the U.S. and EU relied heavily on the principle of equivalence. In derivatives, several pointed to the 2016 agreement on clearinghouses as a good example of the use of equivalence, as well as the principle of reciprocity. There appeared to be a broad consensus that this was a safe and effective way to ensure cross-border access for both EU and U.S. financial institutions, clearinghouses, and end-users. However, a number of participants expressed serious concern that the equivalence determinations that underpinned transatlantic trading could be reopened as result of Brexit. If the EU decided to punish the UK by concluding that its (identical) regime was not equivalent, it would logically seek to reopen its existing equivalence determinations for the U.S. According to some participants, the EU was already demanding that it be allowed to monitor and potentially intervene in U.S.-based CCPs, which was not part of the 2016 agreement. If the EU were to go back on its supervision agreements with the U.S., participants warned that there would be a strong reaction. The U.S. would almost certainly not agree to dual supervisory rights; without that, the EU could demand relocation of some financial services to the EU. That would contribute to fragmentation and lead to high prices and inefficiencies.

Transatlantic asset management could also be affected by Brexit. It was noted that $1.5 trillion of EU funds are now managed outside the EU through delegation, with about 20% of total EU assets under management in the U.S. Given the importance of London for EU asset management, that amount would multiply. U.S.-based asset managers were watching the Brexit negotiations nervously to see which functions would be allowed to stay in the UK, as the final shape of Brexit would likely affect the rules for delegation everywhere, including the U.S.

Over time, regulatory differences were seen by many participants as likely to increase, especially with the UK out of the EU. These participants predicted that, without the more *laissez-faire* UK as a member, EU regulation was likely to become less market-friendly, instead emphasizing the importance of other social and political goals, such as financial stability, localization of financial activity, investor protection, and environmental protection. In contrast, the U.S. was seen to be moving away from the re-regulatory agenda of the post-crisis period. The likely increase in U.S.-EU divergence in financial regulation would need to be managed carefully. (Many participants predicted that UK financial regulation would also shift in the direction of deregulation and liberalization over time, potentially moving its financial regulatory regime away from the EU and closer to the U.S.)

If divergences were to expand between the U.S. and EU, participants predicted that equivalence determinations would become politically more difficult to maintain. Similarly, the EU's willingness to continue to allow for delegation in asset management could also be in question. This raised serious questions for a variety of financial institutions operating in the transatlantic space. However, it was recognized that the effects would vary significantly by sector and function. Participants noted that regulation for some functions, such as retail banking and insurance, was largely based on subsidiarization already, so the effects of U.S.-EU divergence would be minimal. In contrast, clearinghouses would clearly be affected by a shift away from equivalence; for clearing, localization would mean loss of cross-border business opportunities, fragmentation, and inefficiency. Asset managers would likely be significantly affected by constricting delegation, but the extent would depend on whether localization extended to core functions or just to sales.

Regulatory divergence could also contribute to new issues of contention between the U.S. and EU. A major concern for some participants was data. Clashing principles and laws regarding data privacy were already causing complications for some transatlantic financial activities. These would be compounded if either the U.S. or the EU were to demand data localization. If financial institutions were put in a position where they could not satisfy conflicting U.S. and EU regulations, cross-border business would be very adversely affected. Competing visions of proper risk management could also lead to very different regimes of regulating financial institutions' risk management strategies and practices. The challenges of cross-border resolution of a financial institution remained a concern as well.

Future of Transatlantic Relations

Finally, Brexit was seen as inevitably complicating the conduct of transatlantic relations as the number of major actors increased from two to three. However, effective US-European regulatory cooperation was seen as more important than ever. Participants discussed how cooperation and coordination among the U.S., EU, and UK should work.

One issue was whether transatlantic cooperation would be trilateral or "layered bilateral" (i.e., through ongoing bilateral U.S.-EU and U.S.-UK, and EU-UK processes, but without full coordination among any of the levels). While some participants stated a preference for trilateral cooperation, which they saw as more useful in reducing duplicative efforts and coming up with common solutions, others were skeptical that it would prove to be politically or practically feasible. One reason, at least for the near future, was the Trump administration's stated preference for bilateral agreements. Some participants also felt that, with the UK no longer playing the bridge role between the U.S. and EU, divergent financial interests and regulatory preferences would increase the difficulty of trilateral cooperation. Finally, several participants noted that many of the U.S. opportunities for cooperation and coordination with the UK would be different from those with the EU once Brexit had removed London from the EU's regulatory ambit. The Trump administration's oft-stated goal of creating a U.S.-UK FTA was mentioned as an example.

Many participants saw U.S.-Europe cooperation as being of increasing importance as the G20 post-crisis agenda wound down and the gaps between developed and developing country members once again came to the fore. They argued that the size and sophistication of U.S., UK, and EU markets offered the opportunity to provide leadership globally. It was less clear how that might work after Brexit. Some participants recalled the U.S.-UK bilateral cooperation that had initially given birth to the Basel Agreement; given the global importance of New York and London financial markets, they felt that the U.S. and UK again had the opportunity to lead, especially since the UK was no longer fettered by the interests and preferences of continental Europe. Others argued that the U.S.-EU bilateral relationship remained the most important for creating and enforcing standards of competition and macroprudential supervision worldwide.

Participants had varied ideas about how ambitious cooperation should be. Some echoed the U.S. administration's suspicions of global standard-setting, and thus argued that transatlantic cooperation should focus on coordinating implementation of new policies, plus supervisory cooperation (e.g., MOUs, information sharing, supervisory colleges, simulations of cross-border

resolution). Ohers argued that the U.S. and Europe should be working together to set standards and develop financial policies of a wider scope.

Finally, a number of participants warned that the same populist political forces that had led to Brexit could threaten transatlantic cooperation. They noted that resentment of globalism remained strong in the U.S. and a number of European countries. They also questioned whom UK voters would blame if economic inequality or stagnation were to follow Brexit. As with global cooperation, they predicted that ongoing suspicion of foreigners and bankers in many countries could continue to complicate transatlantic cooperation—and the more ambitious the degree of cooperation, the more likely that those resentments would be triggered.

Session 3: MiFID II Trading and Market Structure

In Session 3, participants discussed the effects of MiFID II and MiFIR on trading and market structure. They addressed a number of key issues, including the unbundling of research, reporting of prices, fragmentation, trading in exchanges and other venues, and extraterritorial effects.

MiFID II

MiFID II went into effect in the EU in January 2018, bringing with it a host of new rules and requirements for financial market participants. Together with MiFIR, MiFID II was meant to increase competition and transparency in EU financial markets, with the ultimate effect of reducing costs and improving information so as to support fair and efficient allocation of capital. It created new obligations for market participants to provide timely information to markets, increase the transparency of trading in certain derivative contracts, and dictate how broker-dealers should pursue best execution for clients.

Before MiFID II went into effect, there had been trepidation about some of its new provisions, including the unbundling of research, how to manage cross-border trades, and how to ensure pre- and post-trade transparency. However, participants agreed that MiFID II's entry into force had mostly gone smoothly and new data reporting systems, including legal entity identifiers (LEIs), had gone live without causing disruption. That said, the entry into force of some of MiFID's more ambitious provisions had been delayed in order to prevent major glitches—ESMA had issued several hundred opinions on pre-trade transparency waivers and position limits within the EU, and the SEC had issued a no-action letter regarding unbundling of research for U.S.-based financial institutions.

Another concern prior to implementation of MiFID II was over how it might affect trading patterns and liquidity of financial instruments. It was reported that the changes had so far not had large impacts on overall trading volumes or liquidity in equities (although some participants noted what appeared to be a modest negative effect on bond liquidity). While volatility had returned to EU markets, participants did not attribute that change to MiFID II, but rather to other economic trends. However, MiFID II was already seen to have had profound effects on where trading was occurring—in particular, participants expressed concern about the double volume cap rule (DVC) for dark pools, which effectively capped trading of a given security on dark pools to a maximum of 8% of market cap and 4% for a single venue in a six month period. Although the implementation of the DVC had been delayed until March, participants reported that dark pool trading in the EU had declined over 90%. This was largely by design, as MiFID II had intended to move more trading to public markets. In Europe, it was also observed that much of the trading that had shifted away from dark pools had migrated to systemic internalizers or periodic auctions rather than public exchanges. The implications of this shift were as yet unclear. Participants agreed that, going forward, it would be important for ESMA and other regulators to continue to monitor, report, and calibrate requirements, and to foster supervisory convergence within Europe. In contrast, U.S. alternative trading systems were not directly affected, as EU authorities had concluded that, even though they lacked pre-trade transparency, they were not

really “dark pools” under MiFID II because post-trade pricing was made available through the consolidated tape.

Information and Research

One of the key objectives of MiFID II was to improve transparency in financial markets across several dimensions by the reporting of quotes, trades, and fees. Two major elements were “unbundling” (requiring broker-dealers to separate their charges for execution and research and new requirements for trade reporting.

Unbundling was a major concern for many participants. One reason was its extraterritorial reach, such that any foreign financial institutions trading with European clients would be required to charge those clients separately for execution and research. However, under U.S. law, U.S. brokers that provided research to EU asset managers could become subject to regulation as investment advisers and possibly face an enforcement action by the SEC for failing to register as investment advisers. Participants noted that an SEC no-action letter had given U.S.-based financial institutions a two-and-a-half year respite from this requirement, and that consideration was ongoing to make the exemption permanent. Nonetheless, U.S. financial institutions (like all brokers and asset managers doing business in the EU, whether local or foreign) were required to charge EU clients separately for research. For this reason, a number of participants felt that the no-action letter did not go very far in reducing the extraterritoriality of MiFID II’s unbundling provisions. Moreover, if the SEC’s temporary exemption for asset managers from having to register as investment advisers were not to be made permanent, participants argued that MiFID II would have the effect of imposing significant new costs on those that continued to do business in the EU.

There was also considerable discussion of trade reporting. MiFID II called for much greater transparency regarding pricing, including post-trade reporting for OTC trading. Many participants offered positive evaluations of the principle of better post-trade reporting. In particular, many of them pointed to the U.S. consolidated tape system as an invaluable resource that had contributed to the development and efficiency of U.S. financial markets. However, participants voiced a number of continued dissatisfactions with trade reporting in the EU, which does not include a consolidated tape. First, these participants pointed to a significant increase (25-300%) in the cost of market data since MiFID II had come into effect in January. They argued that this was actually decreasing pricing transparency, as some market participants could not afford these higher costs and therefore would lack access to important data. Second, several expressed doubts that a consolidated tape system would ever emerge, given the fragmented trading landscape and high cost of market data. Third, a number of participants expressed frustration at the way that post-trade data was being made public. They observed that, although the data was being made publicly available 15 minutes after the trade, in compliance with the law, it was ephemeral—often just flashed briefly onto an exchange’s webpage. This made it largely useless. While EU regulators were aware of the issue, there was as yet no resolution.

The lack of a consolidated tape was of considerable concern to many participants. Some, pointing to the U.S. case, argued that consolidated tape was almost as valuable to market participants as pre-trade transparency. They noted that the U.S. had a collective approach to create the consolidated tape, whereas the EU had chosen a different approach that had allowed

large price increases for trade data, while at the same time fragmentation of trading venues made consolidation impractical for the time being. While users of market data showed a strong preference for the U.S. system, some participants also expressed concerns about the pricing of data there, arguing that exchanges were acting as profit-maximizing entities and using their monopoly positions to force data users to pay high prices. They called for more transparency of pricing and examination of governance models of exchanges and the coalition producing the consolidated tape. Furthermore, some participants pointed out that the data provided through a required consolidated tape was often stale compared with data obtainable through private feeds from U.S. exchanges. Participants noted that the SEC was currently assessing the entire system of trade reporting—one possible outcome would be to abandon the consolidated tape requirement (which permitted exchanges to have a monopoly to determine data fees) and allow competition among consolidators in providing such information through consolidating the faster private data feeds available from individual exchanges.

Market Fragmentation

MiFID II, like its predecessor, also sought to increase competition among trading venues. Many participants agreed that MiFID had succeeded in expanding the range of trading venues and ensuring robust competition among them. EU investors have the option of trading securities across a variety of venues, including exchanges, multilateral trading facilities, dark pools (although MiFID II restricted their usefulness considerably), and systemic internalizers.

Despite MiFID's success in expanding competition among trading venues, some participants argued that this had come at a considerable cost. A major concern was market fragmentation. There was such an array of venues that some participants argued it made implementation of best execution more difficult because of the difficulty of comparing pricing in real time.

A number of participants were also critical of the negative impact of MiFID II on dark pools. They saw dark pools as an essential trading platform for traders of large blocks of securities in order for sellers to be able to sell at prevailing market prices without creating large price movements or distortions. While acknowledging that moving trading away from dark pools was in fact intentional as a means of ensuring greater market transparency, these participants cited research that showed that dark pools actually reduced transaction costs for investors since they allowed trading of large blocks without causing large movements in prices. They argued that as long as post-trade prices were reported quickly and accurately, dark pools had no negative effect on transparency. A number of participants also observed that trades that would have occurred in dark pools prior to MiFID II's DVC rule had not shifted to exchanges or MTFs, but had instead gone through other OTC mechanisms (market makers, periodic auctions, etc.) or—increasingly—though systemic internalizers. Participants were unsure how to assess the impact on efficiency and pricing of the move toward systemic internalizers, but several expressed skepticism that they would be an improvement over dark pools.

Although there were a number of questions and concerns regarding the effects of MiFID II, many participants conceded that it would not be possible to assess the impact until more time had elapsed, more data had been collected, and the rule had been fully implemented. Fortunately, they noted, EU rules required review of legislation three years after implementation, so there would automatically be an assessment at that time.

Session 4: Index Investing Versus Active Management

In Session 4, participants discussed the rise of index investing and its implications for financial markets and financial institutions. It was noted that index investing, including through mutual funds or exchange-traded funds (ETFs), had risen rapidly in the four decades since the first index mutual fund had been introduced. Several participants identified this as one of the most important investment trends during that period, particularly in the U.S.

Relative Performance

Proponents of index investing identified several advantages of the approach. One of these was significantly lower fees compared to actively managed funds—averaging around 10 basis points as compared to around 80. As a result, it was argued, active managers would have to significantly outperform indexes just to equal their fee-adjusted performance. It was also noted that, since index funds tended to have lower turnover of assets, there may be tax benefits as well.

Participants discussed at length the claim that index funds generally outperformed actively-managed funds. It was noted that the average active managers underperformed their benchmarks over nearly all time periods. While this did not imply that active managers could not outperform their index, index proponents argued that underperformance was the norm. Moreover, very few actively managed funds outperformed their indexes consistently over a period of years, and index funds' returns tended to be less volatile than actively managed funds holding the same types of assets.

One explanation offered for the apparently better performance of index funds was the shift toward professional management of securities. With fewer retail investors doing their own stock- or bond-picking, professional managers had less space to profit off of their superior research, knowledge, and trading skills. Thus, some participants argued that active management had gotten harder as the competition had become more professionalized and better trained, access to and quality of information had been improved, and trading techniques such as high-frequency trading had expanded. Some participants also raised the possibility that benign market conditions, such as the ones US equities had experience in recent years, may have advantaged passive investors. With the return to greater volatility and the reemergence of two-way movements in both stocks and bonds, they suggested that active managers might again have an advantage.

Not all participants were convinced of the superiority of passive investing. Some argued that skillful managers could beat indexes, and sophisticated investors could benefit from active strategies. Others pointed out that average returns were not the only way to measure performance—for example, some investors might value lower volatility, and thus prefer actively managed funds that focused on risk management. Others may want to take bets on (or against) particular sectors or macroeconomic conditions, or simply hedge against losses on their other positions.

A number of participants also noted that, whether using passive or active managers, investors' strategic asset allocation decisions were likely to be particularly important in both returns and volatility over the long run. Choice of asset class remained in the hands of investors, despite the common use of the term "passive investment." Moreover, several participants emphasized that

not all indexes were created equal. While much of the discussion on index investing had focused on broad market indexes such as the S&P 500 that sought to represent an entire asset class, a number of participants expressed concern about the proliferation of specialized indexes, such as narrow sectoral indexes. Participants also showed mixed feelings about funds that were seeking to blur the distinction between passive and active management, such as "smart beta" funds and custom indexes. While some saw them as an opportunity to blend the advantages of passive and active investing, others saw them as likely to increase costs while reducing the advantages of passive investing.

There was also some discussion of different vehicles of index investment. Several participants noted that index investing displayed much lower penetration outside the U.S., and that even within the U.S. penetration was higher in equities than in bonds. They wondered if there was something distinctive either about U.S. markets or about equities that made index investing more attractive. Others argued that the difference was probably due to investors' experience. Index investing had a longer history in the U.S. than in the EU and elsewhere; similarly, stock index funds had been available longer than bond funds (and particular stock indexes, such as S&P 500, longer than specialized index funds). These participants predicted that the share of index funds would increase as investors became accustomed to them and learned about their advantages. A similar case was made for ETFs, which a number of participants expected to continue to grow. That said, some participants also pointed to the importance of some structural and regulatory differences between the U.S. and the EU, for example in distribution, investment advising, and commission transparency.

Finally, some participants suggested that a big part of the backlash against index investing was due to the loss of fee income and of fund manager jobs resulting from consolidation among actively managed funds, rather than out of concern for investors.

Impact on Markets

Participants discussed at length the potential impact of index investing on markets. Some expressed considerable concern about how index investing would affect price determination, liquidity, and corporate governance, while others dismissed those concerns as overblown.

Potential impact on price determination was a major point of discussion. Several participants pointed out that efficient price determination required that investors take positions on particular securities based on their assessment of the differing economic prospects of the issuers. In this sense, price determination would require participation by active investors. By improving price determination, it was argued, the presence of active investors would also lead to better capital allocation. In the end, this would improve returns for all investors, including passive investors—in other words, these participants saw active investors as necessary to push companies to compete. A related concern was over market liquidity. Some participants worried that liquidity and execution would suffer if passive investing became dominant, since funds would hold stocks in the index regardless of corporate performance, thus arguably reducing the efficiency of financial markets.

Many participants pushed back against these claims. Some argued that markets provided a self-correcting mechanism for bad investment choices. They pointed out that if markets were

mispricing securities due to index-driven herd behavior, it would actually increase opportunities for active managers or activist shareholders to make money by differentiating between stronger and weaker issuers, as well as through arbitrage. Beyond that, many participants were skeptical of claims that passive investment was driving market prices at all. They pointed out that, despite the rapid growth in index investing, it remained a relatively small part of total securities holding. This was true even in US equities, where index investing had progressed the furthest. In the US, ETFs and index funds accounted for about 40% of equity mutual funds, but only about 20% of equities were owned by mutual funds and ETFs. Hedge fund assets alone approached the size of index funds. Moreover, due to index funds' passive approach, they accounted for a much smaller proportion of total trading than their total market share, which meant that active managers were driving price formation.

Another concern raised was the potential for herd behavior and correlation risk. If investors ran for the exits, some worried, there could be systemic effects. Others countered that there was little evidence to support such concerns. Most index funds were held by retail investors without leverage, and they tended to behave as long-term investors—thus, some participants argued that index funds were actually more likely to serve as buffers against the price swings that could result when highly-leveraged investors had to unwind holdings in a dip. It was also noted that, even though there had been a high volume of outgoing trades in high-yield ETFs recently, it had not led to loss of market liquidity or price drops. However, one lingering concern for some participants was the possibility that there might be a significant mismatch of liquidity between some ETFs and their underlying assets that could create problems for investors in volatile markets.

Another concern raised by several participants was that passive ownership might reduce market discipline and incentives for better corporate governance. This was disputed by a number of participants who argued that index funds were as active in voting proxies as actively-managed funds. Indeed, they pointed out that big passive fund managers were substantially increasing their stewardship teams to better monitor and shape firms' corporate governance. Not all participants were convinced by this line of reasoning, however. They pointed out that proxy votes seldom went against the wishes of management, and argued that the real discipline on companies had to come from market competition and the constant threat of losing shareholder value if they made mistakes or were poorly managed.

Finally, a number of participants argued that it was likely that the rise of passive investment had contributed to consolidation in the active fund industry and was likely to lead to further consolidation. Moreover, as lower-performing active managers were forced out, then the quality of the remaining active managers would rise—while this might be beneficial for investors, it would also make it more difficult for managers to achieve above-average performance. Consolidation would be exacerbated by the downward pressure on fees that had been created by passive investment funds. Not all participants expressed concern about consolidation of the funds industry, noting that better performance and lower fees would be beneficial to investors.

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