CONVENTION OF INDEPENDENT FINANCIAL ADVISORS

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THE COVID-19 PANDEMIC CRISIS AND THE TRUE FACE OF THE FINANCIAL SYSTEM REGULATION

Regulation was, and is, needed in a financial system that places a priority on debt and leverage rather than on equity. Such a system, where money is so cheap due to its unlimited supply, in the long run, hurts the middle and lower classes who can't build wealth and overly benefits the top 1% and 10% who end up possessing most of the liquidity use in financial markets. However, rising financial markets do not raise all ships equitably. Moreover, "equity" is the foundation of safety for economies and financial systems. Therefore, the priority should be to protect and enhance equity capital.

Financial systems and real economies, joined at the hip, are cyclically facing major crises. Central banks, the firefighters called upon to confront threats to financial markets and economies, have cornered themselves in an upside-down world of ultra-low and negative interest rates. Various structural factors, such as low productivity growth, aging populations and risk aversion, kept economic growth and inflation low around the world, making it difficult if not impossible for central banks to raise rates. Financial excesses dominated the last decade, then five years ago some central banks turned to negative interest rates to fend off deflation. Today, they are left with empty hands and no conclusive results. Worse, the necessary room to maneuver in time of crisis is not there, i.e., to lower rates by 5% on average in order to effectively engage the economy in the right direction and boost growth. As a result, 'quantitative easing' has been the favored central banks' tool to channel abundant liquidity into the financial systems. Central banks and governments have been pushing policy to extremes, causing as well an unprecedented expansion of public debt. Hence, the prolonged "ultra-low central bank interest rates" policy inexorably leads to a serious mis-allocation of capital and jeopardizes the financial system that it supposedly attempts to save.

In light of the global debt build-up, increased regulation has been believed to be able to rule out another systemic crisis. Hence, since the last serious global financial crisis in 2008-2009, global financial regulators have imposed on the financial intermediation industry a "tsunami" of regulatory rules and compliance obligations, all in the name of protecting the investor, his savings and his pension fund. The world is paved with good intentions. But, are they truly good for the designated receiver?

The **Convention of Independent Financial Advisor** (CIFA), is the custodian of the **Charter of Investors' Rights**. CIFA, as such, is very sensitive to actions taken by regulators during this period of twelve years where financial markets have evolved under significant pressure from regulators, a pressure that has been especially heavy on small and medium size actors of the global financial industry. For instance, the UK's Heath Report 3, focused on the availability of advice for UK customers (before and post-RDR), established that, whilst adviser numbers had stayed broadly the

same, the ratio of clients to advisers had dropped further to just 160, thus removing advice from another 3.5m consumers – a total of 17.5m.

We want to stress out the fact that all current heavy regulation (MIFID in Europe, RDR in the UK, FinSA-FinIA in Switzerland … to name only a few) has been promulgated by the legislative arm in each country and its servants, i.e., the surveillance agencies (quite abundant in Europe: ESMA, EIOPA, ESAs, EBA, etc.) based on the unique arguments put forward, that is to protect the investor/saver and to stabilize the financial markets with various restrictions and/or certifications of all sort of complex financial products and strategies ("risk parity", all-weather funds, auto-callable structured derivatives, "risk recycling", bond ETFs trading at prices very distant from the underlying bonds, mutual funds and ETFs erroneously promising buyers 'liquidity' when they rush to sell illiquid products, etc.).

Considering the unprecedented and simultaneous meltdown that is straining financial markets and bruising investors across the globe today, how does the ordinary investor and the financial intermediary feel about (a) the heavy cost of regulation imposed on them over the last 12 years, and (b) its efficiency?

Regulators will always find a way to justify their decisions. They might probably argue that they very well knew that most rules and regulation they implemented could be at least inefficient, if not altogether toxic, but that they were forced to implement the rules edicted by the legislative and political powers. The latter might argue that it was not their decisions, but their not-reelected predecessors' actions.

We already know what the conclusion will be: it's nobody's fault! However, this shall not keep us from asking some questions, such as:

- Has the current regulation protected the private Saver/Investor from incurring significant financial losses?
- Has the current regulation protected the Institutional Investors from incurring significant losses?
- Considering that Central Banks around the globe are injecting unprecedented amounts of cash into the financial system (far more than in 2009, but this time before the ATM's are empty), has the current regulation made the Systemically Important Financial Institutions (SIFIs) safer?
- Has the current regulation reduced significantly the market share of Organized Crime? Apparently, it continues to progress at a higher rate than GDP.
- Since Pandemia has been a high-risk factor on the regulators list, have you received, when the COVID19 crisis began up to present, any guidelines from your regulator in relation with the protection of the assets/wealth of your clients/savers/investors?
- Systemically Important Financial Institutions (SIFIs) will be bailed out by massive liquidity injections. Do you believe this will also be the case for small and medium size financial advisors/institutions or for the saver/investors who lost a significant amount of money by acquiescing to the advice of SIFIs?

If your answer is 'YES' to all the above questions, then throw this paper into the trash.

If your answer is mostly 'NO', then you might want to do something ... but, what?

- You may contact your local political representative and ask him/her the questions you answered with 'NO'.
- You may contact your regulator and ask him/her the questions you answered with 'NO'.
- You may contact your friends/journalists and share with them your concerns not only about the health situation, but also about the financial situation and its mismanagement by the authorities/regulators.

It appears now very clearly that the regulatory 'tsunami' was never meant to protect the investors, but rather to protect the large financial and systemic institutions from potential claims from the saver/investor.

If we keep doing the same things over and over again, why should we expect different results? As long as interest is tax-deductible while dividends are not, we will always have a system that is addicted to debt and leverage. This debt creates revenues and rewards to the big systemic institutions in the good times, and gets rescued in the bad times by the tax-payers. So, why should this cozy relationship between governments and SIFIs end? History has made it very clear that the root cause for the majority of market meltdowns—impacting both personal portfolios and business balance sheets—has been attributable to excess debts and over-leverage. Remember, incentives drive behavior! Governments and Regulators should create policies that encourage dividends and equity funding—like making dividends tax-deductible—just like interest. We might see a more stable and stronger economy instead of the cyclical financial fragility due to excess leverage!

CIFA will continue to encourage dialogue and action among all stakeholders to overhaul a financial system that must "de-leverage" in order to contribute meaningfully to the UN-SDGs!

The CIFA Team