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Dear Ms McHale

## **FSA CONSULTATION PAPER 115: IMPLEMENTATION OF THE INTEGRATED PRUDENTIAL SOURCEBOOK**

The Investment Management Association is grateful for this opportunity to respond to FSA Consultation Paper 115, on the implementation of the Integrated Prudential Sourcebook. The IMA is the trade body for the UK investment management industry. It has some 175 companies as full members, between them managing over £2 trillion of assets, including over £2 billion (99%) of authorised collective investment schemes as at the end of 2001. It was formed by the merger of the Association of Unit Trusts and Investment Funds (AUTIF) and the Fund Managers Association (FMA), which took place on 1 February 2002.

This letter contains some comments on issues of particular significance for our Members. The annex to this letter gives the IMA's detailed response to a number of the questions posed in the Consultation Paper.

At a general level, we note that developments in the Basel process since the publication of CP115 have made the implementation process more rather than less difficult. Our current view is that it would be unwise to expect the new Basel Accord to be finalized before early 2003. There is thus a risk that the implementation of the revised Basel Accord may slip beyond the 2005 date envisaged in CP115. In addition, in April 2004 the European Parliament will dissolve for the June 2004 elections. Unless the present Parliament concludes the first reading on a new capital directive based on the revised Accord with a Resolution before it dissolves, any progress made up to that date would be lost. Even if formal progress is not lost, there may be a delay while the new Parliament convenes and picks up the issue. The implementation of the revised Accord and the new directive might therefore become de-coupled. We urge the FSA to undertake contingency planning for both these eventualities, and to involve the industry fully in this process.

We support the point, made in paragraph 3.1iii, that group-related issues will need special consideration. Many of our Member firms are part of groups, which may be insurance, banking or securities groups or conglomerates. Others are independent entities, or part of asset management groups. If the implementation of the PSB proceeds at a different pace for different kinds of groups, or for different parts of a group, this may result in additional cost and confusion, as well as possible competitive distortions. The possible adoption of a European Financial Conglomerates Directive in 2002 only complicates matters further. The IMA is planning to hold discussion with the FSA on matters relating to the prudential supervision of groups and its implications for member firms.

The main specific concerns of our members who are CIS managers relate to the implementation of the revised European Directive on Undertakings for Collective Investment in Transferable Securities (UCITS). The revised UCITS Directive introduces a new regime of capital requirements for UCITS firms, which is not reflected in the draft of the PSB (a point AUTIF noted in its response to CP97). This regime draws in part on the regime in the Capital Adequacy Directive (CAD). CP115 acknowledges the need to implement this directive in paragraph 2.7(c), but fails to follow it through by factoring implementation into its subsequent analysis and recommendations. For example, it is not mentioned in the list of future consultations in Annex B.

I must also draw to your attention two additional complications, not mentioned in CP115. The first is that the revised UCITS Directive requires the Commission to report to the Parliament and Council on the application of the capital regime, along with proposals for revision where appropriate, no later than 3 years after the entry into force of the Directive. It is by no means inconceivable that as a result of this revision the capital regime might be replaced by a regime derived from the Basel operational risk capital requirement. This is the equivalent in the UCITS sector of the point made in paragraph 4.18 of CP115. The second complication is that the revised Directive empowers national competent authorities to allow firms to undertake certain kinds of business within the scope of the Investment Services Directive (ISD) (such as discretionary portfolio management) from within the UCITS entity. In respect of such business, the CAD regime would apply.

The revised UCITS Directive was adopted on 4<sup>th</sup> December 2001, and came into force in February 2002: on that basis, Member States will have to implement it by August 2003 at the latest, with the 3-year review being due by March 2005. Although Member States must implement by August 2003 (with the FSA having rules in place by that date) there is a transitional provision stating that individual firms may be allowed up to 5 years to comply. This provision may be a lifeline for smaller firms, where current capital requirements are well below even the minimum UCITS requirement of €125,000.

Implementation of the revised Directive is clearly an additional complication for the overall PSB implementation process. In our view, there are two options.

1. Incorporate the revised UCITS Directive in the PSB, and implement that part of the PSB in time to meet the mid-2003 deadline. Then revise the PSB to take account of any revision to the UCITS capital regime resulting from the 3-year review.
2. Incorporate the revised UCITS Directive in the Interim Prudential Sourcebook for Investment Firms, and then incorporate either the original revised UCITS regime or the revised revised UCITS regime in the PSB as part of a more widespread implementation process.

Neither option is perfect: in particular, neither protects UCITS firms against possible revision of the UCITS capital regime consequent on the 3-year review, or from possible changes in the CAD consequent on the adoption of the revised Basel Accord. Of the two options, the IMA's marginal preference is option 1. There is no guarantee that it will be possible to create rules in the Interim

Sourcebook that are capable of transcription into the PSB. In any case we are not sure that this would avoid the need for two sets of consultation. As is the case with the technicalities of the revised UCITS Directive, we look forward to working positively with the FSA in taking implementation forward.

If you wish to have any further information concerning these comments, please do not hesitate to contact us.

Yours

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