

25 June 2003

Mr Patrick Wogan
Committee Office
House of Lords
London
SW1A 0PW

Dear Mr Wogan,

Inquiry into the European Commission's Financial Services Action Plan

Thank you for your letter of 9 June 2003, inviting the Investment Management Association ('IMA') to submit written evidence to the House of Lords Sub-Committee inquiry into the European Commission's Financial Services Action Plan ('FSAP').

IMA represents the UK-based investment management industry. Our Members include independent fund managers, and the investment arms of banks, life insurers, and investment banks. They are responsible for the management of over £2 trillion of funds (based in the UK, Europe and elsewhere), including authorised investment funds, institutional funds (e.g. pensions and life funds), private client accounts and a wide range of pooled investment vehicles. In particular, our Members represent 99% of funds under management in UK-authorised investment funds (i.e. unit trusts and open-ended investment companies).

You have invited evidence on a large number of questions. Given the requirement to submit only four pages of written evidence, IMA has focused on your penultimate question about the development of the single market post FSAP (see paragraph 11), because IMA has recently published an independent report (copy enclosed) that looks at precisely this issue.

IMA would be delighted to make our resident experts available to provide oral evidence to the sub Committee on any issue relating to the enquiry.

Yours sincerely

Sheila Nicoll
Deputy Chief Executive

Inquiry into the European Commission's Financial Services Action Plan

Submission by the Investment Management Association

1. ***What progress has been made to date?*** 'Progress' is typically measured in terms of the likelihood of enacting FSAP legislation by 2005. (This deadline was imposed to support the European Union's Lisbon Council objective of becoming the most competitive and dynamic knowledge based economy in the world by 2010.) As things stand, there has been significant progress to date and the majority of FSAP legislation looks likely to be enacted by 2005 or shortly thereafter. However, IMA is concerned that this focuses too much attention on the *speed* with which legislation is enacted, and insufficient attention on the *quality* of that legislation. In particular we would not wish the quality of highly sensitive impending legislation to be compromised by an unnecessarily tight deadline (e.g. the Investment Services Directive, Capital Adequacy Directive, Transparency Obligations Directive and Takeover Directive, Prospectuses Directive).

2. ***Has the FSAP been beneficial or deleterious to UK interests?*** IMA is fundamentally supportive of the principles behind the FSAP. There are good economic reasons to suppose that an internal market in financial services will be highly beneficial to UK interests (following the logic, for example, of the recent HM Treasury EMU study 'The location of financial activity and the euro'), since it will allow UK expertise in financial services provision to be more easily leveraged throughout Europe. However, by no means all of the provisions so far enacted have gone far enough to achieve these objectives and some (for example as regards the country of domicile provisions of the Prospectus Directive) are positively retrograde.

3. ***Has sufficient weight been given to the positions and experience of the UK financial services industry?*** Not every piece of FSAP legislation reflects the preferred position of the UK. Whilst some pieces of legislation are broadly beneficial to UK interests (e.g. the old UCITS Directive and old Investment Services Directive), others are neutral (e.g. the Occupational Pensions Directive) and some add costs without significant benefits (e.g. the Savings Tax Directive). Certain pieces of draft legislation remain highly controversial (e.g. the revised Investment Services Directive). The IMA appreciates that the negotiated nature of internal market law makes such trade-offs likely. However, in the round the IMA believes that the UK is increasingly effective at making its position heard in Brussels. In particular, the IMA commends the work of UK MEPs on the EMAC and Legal Affairs committees, and other UK officials involved in financial services negotiations, including the financial services attaché to the UK Representative Office.

4. ***What are the main outstanding matters that remain to be dealt with under the FSAP and what key issues will need to be resolved?*** Key outstanding legislation includes: the Investment Services Directive; the Capital Adequacy Directive; the Prospectuses Directive; the Transparency Obligations Directive; and the Takeover Directive. We have been particularly concerned that a number of these directives do not properly take account of the needs and concerns of users of markets – of the "buy-side", in an area where attention has traditionally been focused on the needs and concerns of the "sell-side". We recognise that this is

partly because the voice of the “buy side” has not been as strong, a situation which we are seeking to redress.

5. *How successful do you expect the Lamfalussy process to be? Are any changes needed?* IMA is a strong supporter of the principles of the Lamfalussy process and believes that it is important to give it a chance to work before making major changes. Nevertheless its effectiveness is likely to be put into question by the amount of detail which is being contained at all levels of the legislative process: the current draft of the Investment Services Directive contains provisions which have no place in “framework” legislation, and there is a serious danger of CESR becoming overloaded.

6. *Who will be responsible for ensuring effective implementation and enforcement of the single market, after the regulatory Framework is in place? How successful do you expect this process to be?* The fact that local regulators are responsible for implementing and enforcing (‘transposing’) European legislation has three consequences:

- 6.1 ***Complexity.*** First, legislation can be transposed in different ways by different regulators in different Member States, increasing the complexity – and therefore the costs – of cross-border business. For example, the Savings Tax Directive leaves such broad interpretative discretion to local regulators and fiscal authorities, that in the absence of coordination between the authorities and agreement on key concepts, costs and levels of bureaucracy are likely to be extremely high.
- 6.2 ***Protectionism.*** Second, legislation can be transposed in a protectionist manner. For example, in its consultation on the implementation of the UCITS Directive 2001/107/EC the Irish Financial Services Regulatory Authority proposes to refuse an investment company in one Member State to appoint a management company in another Member State despite the Directive’s clear provisions to the contrary.
- 6.3 ***Superequivalence.*** Third, legislation can be transposed in a ‘superequivalent’ manner (i.e. so as to impose higher regulatory standards than was necessarily intended). For example, the UK Financial Services Authority has interpreted certain aspects of the Banking Consolidation Directive, E-Commerce Directive and UCITS (management company) Directive in a superequivalent manner, potentially putting the UK based industry at a disadvantage as compared with those elsewhere in Europe.

7. We believe that it is vital that CESR and its proposed equivalents for banking and insurance, together with the Commission, focus seriously on levels 3 and 4, with CESR actively comparing and coordinating approaches to implementation and the Commission, where necessary, taking action against Member States which do not implement appropriately. We welcome the fact that the Commission is mindful of these problems. In its recent Communication ‘Internal Market Strategies, Priorities 2003-2006’ (IP/03/645) it proposes a number of measures intended to increase the speed and consistency of transposition of internal market law, including: an ‘Internal Market Compatibility Test’ to assess whether specific regulations in specific Member States are compatible with internal market law; a recommendation on ‘best practices’ to speed up and improve the quality of transposition of internal market law; and a study on the different options for improving enforcement of internal market law. We welcome these proposals.

8. **What will be the role of competition regulators at EU and Member State level?** IMA is not aware that the FSAP gives rise to any specific new roles for competition regulators at either the EU or Member State level.

9. **What issues will arise as the single market framework is implemented and enforced?** Please see paragraph 6 above.

10. **What non-regulatory barriers might impede the effective functioning of a single market for financial regulators?** Please see paragraph 11 below.

11. **How do witnesses see the future development of a single market in financial services following implementation of the FSAP?** IMA, with generous financial assistance from the Corporation of London, recently commissioned an independent report to assess the future prospects for the single market for asset management.

12. The report was commissioned from Dr Friedrich Heinemann of the Zentrum für Europäische Wirtschaftsforschung (a leading economic research institute) who was instructed: to identify the economic benefits of the provision of investment management products in a single European market; and to identify the barriers that are preventing those economic benefits from being realised.

13. The Heinemann Report finds that in most countries the market for retail asset management services is still essentially local: British investors buy from British providers, French from French, German from German and so on. Barely 9% of the market for European investment funds can be attributed to genuine third-party cross-border sales. Consequently, Europe is foregoing significant economic benefits (e.g. increased economies of scale, externalities, competition and risk adjusted returns) in the region of €5 billion per annum. (Alternatively, conservatively estimating cost savings from a single market to be approximately 40 basis points (or 0.4%) per annum¹, a single market would increase the pension fund of an individual who saved 10% of his salary throughout his working life by €120,000²).

14. The Heinemann Report identifies various barriers which are holding back the single market for asset management. IMA has prepared an accompanying 'position paper' (copy enclosed) which proposes various solutions to those barriers, i.e. solutions which, if enacted, would facilitate the development of the single market.

15. Those solutions set out in the IMA position paper include a number of measures which require action by the EU institutions:

- 15.1 **Tax discrimination.** Member States' fiscal regimes should not discriminate between returns from domestic investment funds and offshore investment funds. IMA supports ongoing work by DG Tax to bring infringement proceedings against such discriminatory regimes.

¹ For example, SEC Report on Mutual Fund Fees and Expenses, 2001

² This is based on a 25-year-old earning €45,000, contributing ten per cent per annum for forty years, with a salary growth rate of four per cent per annum, and a fund growth rate of seven per cent. Regardless of the assumptions upon which this calculation is based the difference is roughly constant in percentage terms.

- 15.2 **Fund registration.** Once an investment fund has been registered in its home state under the UCITS Directive³ (which enables investment funds established in one Member State to be marketed in others), there should be no need for further registration in all of the other Member States in which it is marketed. This would require a change to the existing approach established in the UCITS directive.
- 15.3 **Fund mergers.** Member States' fiscal and regulatory regimes should not discriminate against cross-border fund mergers. Inclusion of investment funds in the forthcoming Tenth Company Law Directive (on cross border mergers) may be a possible mechanism to achieve this.

16. Equally, IMA recognise that there are a number of areas in which the industry itself needs to act and where working with an effective European representative body involving practitioners and equivalent associations from elsewhere in Europe is likely to be the best way forward:

- 16.1 **Infrastructure.** Infrastructure providers (particularly transfer agents) should standardise the protocols required to process the buying and selling of shares in investment funds, in order to reduce the complexity (and costliness) of cross-border business. IMA proposes to work with interested parties to this end.
- 16.2 **Public data.** Asset managers should standardise the calculation and publication of data on fund classification and performance, costs and financial statements, in order to increase the comparability of investment funds. IMA proposes to work with interested parties to this end, including its sister trade associations elsewhere in Europe.
- 16.3 **Financial advice.** The quality of financial advice should be improved by developing an industry-wide code of conduct/professional rules. This will benefit consumers in countries where the quality of advice is currently low. It will also benefit investment fund providers by increasing awareness of their products. IMA supports the work on the International Standards Organisation in this area and sees this as an area in which cooperation through an effective EU representative body for asset management could be fruitful.

17. Please note that none of these solutions are included in the FSAP. However, some of the solutions are included in other legislative initiatives of the European Commission (for example, the Corporate Governance and Company Law Action Plan, and the Internal Market Strategy).

18. The Heinemann Report and our accompanying position paper was officially launched on 20 May in Brussels, at an event well attended by representatives of the European financial services industry, Commission, Parliament, national representative offices and the media. We are planning one-on-one follow-up with specific Members of the European Parliament and the Commission in order to use the Report as the basis for real and positive change.

19. ***Will the changes resulting from the FSAP proposals have an impact on the competitive position of London and EU markets as a whole in the global environment?*** See paragraph 2 above.

³ A Directive on Undertakings for Collective Investment in Transferable Securities 85/611/EEC