



THE FCA PRACTITIONER PANEL'S

**Response to HM Treasury's Review of the Balance of
Competences:**

**Single Market: Financial Services and the Free Movement of
Capital - call for evidence**

17 January 2014

1. Introduction

The FCA Practitioner Panel (the 'Panel') was established by the Financial Services and Markets Act (as amended) to represent the interests of regulated firms and provide input to the Financial Conduct Authority (the 'FCA'). The Panel provides advice to the FCA on its policies and strategic development of financial services regulation.

The Panel was pleased to discuss a number of topics with Charles Roxburgh at its December 2013 meeting, including the review of the EU balance of competences with regard to financial services. We provide below some further comments and observations regarding the impact of EU regulation on larger UK financial firms and the creation of that regulation.

We have provided our detailed comments below.

2. Executive Summary:

- The Panel recognises the benefits of EU membership for the UK, particularly in terms of trade and investment;
- However, rules emanating from the EU have a significant impact on UK businesses, including taking up significant amounts of management time and firm resource;
- The Panel is supportive of high-quality regulation, whether created at EU-level or domestically, provided it is effective, proportionate and designed to balance the competing objectives of financial stability, growth, competitiveness and consumer protection;
- Some legislation is better created at the EU-level, aligned with international standards, particularly for cross-border wholesale markets;
- Retail consumers are not homogenous across the EU, and it may be more appropriate for EU retail market rules to remain high-level or for rules to be created at the national level;
- There are many examples in EU rulemaking where the objectives of growth and competitiveness for the EU and UK have lost out to the objectives of consumer protection and financial stability;
- For minimum harmonisation Directives, the UK must be careful to avoid unjustifiably gold-plating requirements;
- The consequences of restricting or preventing 'third country' firms, investors and consumers from accessing UK markets could have significant negative implications;
- The large number of EU regulatory proposals already being implemented by firms is creating 'change fatigue', and will preclude the ability to successfully make any further changes;
- Inconsistent implementation of rules across the EU, and constantly evolving and overlapping regimes have made long-term planning for firms difficult;
- It is early days for rule-making by the ESAs, although it is noted that they can be inefficient and difficult to engage with;
- The UK has had some success to-date in influencing EU discussions, but there is a concern about the future ability to sway important discussions impacting UK markets. Further efforts must be made by the UK Government;

- EU legislative processes are opaque and have several flaws in terms of consulting mechanisms and proper impact analysis. These areas could usefully be reformed.

Panel response:

1. How have EU rules on financial services affected you or your organisation? Are they proportionate in their focus and application? Do they respect the principle of subsidiarity? Do they go too far or not far enough?

The Panel believes that the effect on the UK financial sector of EU regulation has been and will continue to be significant. Membership of the EU has had a clear benefit for the UK in terms of trade and investment, and has contributed to the success of London as a global financial centre. However, the impact for businesses located in the UK of EU regulation has been felt both in terms of new costs of business (e.g., capital, compliance staff, compliance programmes), changes of business models, and new systems and processes. EU rules (along with domestic changes) are increasingly taking up substantial amounts of time on the agendas of executive committees and company Boards. Senior practitioners are dedicating significant time to understanding and making decisions on changes resulting from regulatory reforms for their firms. Despite this, the Panel continues to believe that properly designed, high-quality financial regulation is essential, both for regulated firms and their customers, to provide needed protections and confidence in providers and their services.

As an example of the impact of EU rules, the insurance industry has been substantially affected by the Solvency II Directive rules. The industry supported the original need for a harmonised prudential regime for the insurance industry across the EU that matched the UK's high-watermark standard. In practice, the process of agreeing the Directive and the direction of travel has meant that the costs may have begun to outweigh the benefits. The Directive has so far taken over 10 years to agree and get to the current position, where we are only now starting to get clarity on certain elements of the requirements. There are of course further details and two more years to go, agreeing both level 2 and 3 requirements, before the rules take effect. There are some industry estimates that this particular Directive has cost the insurance sector between £3bn and £4bn just in the implementation to date. This is money that could have been used to improve services, provide better value for consumers or be committed as infrastructure investment to benefit the UK. The result has been a huge cost, with very little improvement on the robust prudential regime the UK already had prior to the Directive being proposed.

Although it is unclear what the long-term collective benefit of all of the EU rules implemented in the UK has been, compared with their costs, it is obvious that some measures have been more proportionate and better designed than others. Those that have provided substantial cost with only minor improvements in terms of consumer protection or financial stability will clearly be shown not to have provided proportionate benefit. However, we are aware that many proposals have contributed positively and that collectively EU rules have generally led to an improvement in terms of financial stability and confidence in the market following

the 2007 financial crisis. Often, the underlying ideas of proposals are sound, but the devil has been in the detail, and certain technical elements have caused particular concern. It has been important that the UK involves itself in these technical discussions, and explains to EU counterparts the impact of the proposals. However, the process should not be allowed to run away with itself and become bureaucratic, adding substantial time and cost.

Financial Services firms have also found long-term planning amidst the evolving, overlapping and, sometimes, inconsistent EU regulation environment challenging. For example, remuneration provisions appear in a wide variety of EU dossiers, including CRD IV, AIFMD and UCITS V proposals, with subtly different requirements. These provisions have been implemented in a piecemeal fashion over several years, on top of an existing UK regime. The regimes have left some flexibility for national regulators, and we note provisions have been applied and enforced differently in different Member States. While there may be a need to have different regimes for each sector, the constant development in certain areas and non-harmonised regime across the EU, has made long term remuneration planning for firms difficult. This concern is further exacerbated by EU regulation review clauses, which always promise future change.

2. How might the UK benefit from more or less EU action? Should more legislation be made at the national or EU level? Should there be more non-legislative action, for example, competition enquiries?

The Panel notes that there are benefits of having rules set at the EU level, particularly where activities take place cross-border, firms operate in multiple member states or consumers in practice would benefit from greater choice by being able to access services from providers in any of the 28 member states. However, some industry sectors are predominantly domestically focused (e.g., investment advice), undertaken largely by small institutions, and therefore require a more bespoke, focused, national rulebook. Consumers across the EU are not a homogenous group and vary from member state to member state based on a number of factors including: prominence of finance services in the jurisdiction, savings and investment culture, knowledge and capability to engage with financial services, availability of state provision (e.g., state pensions), etc.

In general, the balance between EU and national rules has worked well, although we note that certain specific proposals initiated in the EU would benefit consumers more if created in the UK. For example, the FCA has consulted and worked with industry on rules in the Mortgage Market Review (the 'MMR') on the types of disclosures that consumers purchasing mortgages should receive. The EU rules in the Mortgage Credit Directive regarding the provision of a European Standardised Information Sheet (the 'ESIS') works less well for UK consumers due to the amount of detail provided, but will replace its domestic MMR equivalent in 2018. A further example is the new Payment Accounts Directive proposal, which tries to encourage cross-border switching between current account providers – a practice which is inhibited by a number of structural and legal issues, and for which there is no significant demand. By comparison, there

is demand for national switching and industry has worked with the Government and regulators to develop the 7-day switching system.

Overall, the UK, including its firms and consumers, will benefit if a proportionate regulatory environment is created, whether that be initiated in the EU or the UK. However, the EU must recognise that in some cases there is no reason to create detailed rules at the EU level, and member states should instead be encouraged to create domestic rules (including by issuing non-legislative guides or initiatives, if appropriate).

3. How have EU rules helped or made it harder to achieve objectives such as financial stability, growth, competitiveness and consumer protection?

Since the financial crisis, the EU has put a significant amount of work into creating rules that improve the financial stability of the financial system. This has been a natural area to focus on, and has tried to tackle some of the largest problems facing national governments regarding financial services, such as the 'too big to fail' issue. The next move appears to be trending towards ensuring a more harmonised consumer protection regime across the EU. Again, this is important and addresses some of the poor practice and misaligned incentives discovered in the last five years, but as noted above, solutions may sometimes be better found at the national level.

For many firms, particularly those larger firms operating across the EU and internationally, there has been a serious concern about the impact of EU regulation on growth and competitiveness of the EU generally, and specifically financial centres such as London. Financial services contribute significantly to growth and prosperity in the UK, both in terms of the sector as an industry in itself, but also in its primary function of providing financing, investment opportunities, risk management and protection to corporate clients, investors and retail consumers from all over the world. While it may be necessary to trade off some opportunities for short-term growth and economic prosperity to improve stability and consumer protection for the long term viability of financial services, there is a concern that the EU does go too far sometimes in this respect. There are many possible examples of this, including:

- Solvency II – the costs and capital requirements directly impacting on insurance premiums and annuity rates, and the ability of the sector to invest its reserves in long-term UK infrastructure projects;
- CRD IV – the increased capital cost, which has made it difficult and less attractive to lend to small and medium sized enterprises;
- EMIR – the cost of margin requirements and contributions to CCPs' default waterfalls, making it less viable for investment firms to act as clearing members and more expensive for corporates to hedge their exposures.

All parties (the Government, industry and consumers) should be aligned in their desire to see Europe and London as attractive propositions for global investors, businesses and consumers. However, the EU has made it more difficult for the UK Government to encourage growth and competitiveness and the UK must

continue to work hard to guide the EU towards the right balance of the competing objectives.

4. Is the volume and detail of EU rule-making in financial services pitched at the right level? Has the use of Regulations or Directives and maximum or minimum harmonisation presented obstacles to national objectives in any cases?

EU rules are increasingly including greater detail, and involving more prescriptive rules at the EU level, requiring less domestic implementation. This approach has benefits in certain areas, where it is important to have a single rulebook where firms operating in multiple member states can have confidence that their business models and actions will be treated the same in each country. Particularly, this sort of approach is beneficial for certain of the wholesale market dossiers, aligned with international standards, such as with the Markets in Financial Instruments Regulation. In other areas, it is more appropriate to have a high-level framework, leaving national governments and regulators to find solutions on technical detail that works for the domestic market – particularly in retail markets.

Where EU rules require ‘maximum harmonisation’ or are introduced by way of Regulation, it is important that the UK Government works especially hard to ensure the final rules are appropriate and work for UK firms and markets, given that there is no flexibility once agreed. For Directives that set minimum standards, the UK must carefully consider the consequences if it believes there is a need to go further.

We feel that generally ‘gold-plating’ of EU legislation is not justified in the large majority of cases, as it creates a confused environment for implementing requirements, creates additional cost and undermines the purpose of setting rules at the EU level. It can also further create an uncompetitive environment if the UK decides to create requirements which other member states will not apply to their competing firms. We recognise that with greater use of Regulations and maximum harmonisation Directives this was a bigger concern in the past, but the UK should remain conscious of its actions.

5. How has the EU’s approach to Third Country access affected the ability of UK firms and markets to trade internationally?

The EU’s approach to third country access in dossiers such as EMIR and MiFID create major risks to the UK’s competitiveness position and success as a financial hub. While it is recognised that there is a need to ensure that firms trading in EU markets are subject to high regulatory standards, solutions must be found to ensure that those firms are not barred or discouraged from trading and interacting with UK firms. Industry has welcomed efforts to try and resolve issues with equivalence and substitute compliance, particularly those between the EU and the US authorities. If such issues were not resolved, there could be significant reductions in trade and market liquidity, higher prices, reduced choice and levels of service for consumers and, ultimately, a move away from trading in the EU in favour of more liberal and open jurisdictions such as those in Asia. This situation is unlikely to come about in the short to medium term, but the EU must

ensure workable solutions that balance the competing interests and allow UK firms (and EU firms) to trade internationally, and for EU and non-EU firms to access the UK market.

6. Do you think that more or less EU-level regulation in the area of retail financial services would bring benefits to consumers?

We re-iterate that often retail financial services regulation is best created at the national rather than international level, due to the fundamental differences that exist between consumers in different locations. However, in appropriate areas, it may be best to set high level standards in retail financial services at the EU level, provided it is effective, proportionate and designed to balance the competing objectives of financial stability, growth, competitiveness and consumer protection.

The Panel notes that the industry in the UK and across the EU has undertaken a significant program of change, resulting from regulation, self-initiated programs and as a result of changes to regulatory structures (e.g., the creation of the FCA). If the case is made that further regulation is needed, particularly at the EU-level, consideration must be given as to timing. Many firms are suffering 'change fatigue', and Boards and senior executives are struggling to find sufficient time to dedicate to decision-making on business changes to implement and comply with the rules. Equally, the resources of businesses are stretched in terms of implementing new training courses, procedures and systems to meet the requirements. If new EU-level regulation is required, we would welcome the UK Government emphasising as an important consideration that there is a greater lead in time to implement EU rules and the avoidance of multiple different changes being required at the same time.

7. What has been the impact of the shift towards regulation and supervision at the EU level, for instance with the creation of the European Supervisory Authorities? Should the balance of supervisory powers and responsibilities be different?

Detailed regulation at the EU level via the European Supervisory Authorities (the 'ESAs') has had mixed success to date, and it is noted that it is still early days for these organisations. Where previously the European Commission created the high-level rules and national governments and regulators (e.g., the FCA) created the technical detail, the ESAs now add a further layer in to this process. In some cases, this has proved inefficient, particularly where the ESAs rule-making powers still require Commission approval before finalisation, and further still where that approval is with-held or subject to negotiation. There are instances where technical detail at the EU level would be appropriate and has been successful, but the process of creating these types of requirements should not be overly bureaucratic. ESA level requirements need to be as proportionate and balanced as the high-level proposals, and be prepared by parties with the required knowledge and skill to ensure the rules achieve what is required without unintended consequences.

The ESAs themselves have proved difficult to deal with so far. Their public engagement and consultation processes are opaque, and do not always take sufficient account of the comments provided by stakeholders. They have also been slow to respond to questions and queries, and it is sometime difficult to find the right parties at the authorities to talk to – for example, the consultation papers published by the ESAs do not provide a contact name or email address in their documents like the FCA and HM Treasury do. The Panel feels that rule-making at the ESA level is less accountable, particularly to firms in the UK where a majority of EU financial services activity takes place. Wherever detailed rules are created, there needs to be adequate stakeholder engagement and consultation to ensure effective rules.

So far, supervision by the ESAs is limited to trade repositories and credit rating agencies (by ESMA). We believe these bodies may have a useful coordinating role in future, but that we should not be working towards a future in which the UK market is entirely supervised by supervisors outside of the jurisdiction, who will lack the necessary local knowledge.

8. Does the UK have an appropriate level of influence on EU legislation in financial services? How different would rules be if the UK was solely responsible for them?

The Panel is aware that HM Treasury and the UK regulators ‘punch above their weight’ in contributing to and influencing the progress of EU legislation through the legislative process. However, given the importance of the financial services industry to the UK economy, we believe more could and should be done.

It is recognised that EU treaties limit the role that member states have in creating EU rules and that the UK only has 1 vote in 28 in Council meetings and at the ESAs. These are inevitable features of having a European Union of many member states with different competing interests. However, if the UK were responsible solely for rule-making, we suspect that many of today’s requirements would still be implemented in a similar form. There may though have been greater consideration of the growth agenda, if the UK Government were the sole creator of rules. In the current environment, the Government must work with the FCA and PRA, as well as industry, to ensure there is a joined up and comprehensive engagement in Europe that gets the right results for UK firms and consumers.

9. How effective and accountable is the EU policy-making process on financial services legislation, for example how effective are EU consultations and impact assessments? Are you satisfied that democratic due process is properly respected?

The EU policy-making process is highly technical and very opaque for all but the limited numbers of parties who are directly involved in the process. This opaqueness means that the vast majority of stakeholders place significant emphasis on public consultations, and use these to make their views heard. The process of consultation can be both too late in the process, conducted over a short time-period and lacking in detail. For example, it is noted that the European Commission never consults on the text of rules themselves but only on

high-level concepts. Some consultations which have brought about major changes have been short on details and conducted over only a 1-2 month period.

Impact assessments and evidence bases are a further major concern, and are often felt to be weak. An important example of this was the proposal for a Directive introducing a Financial Transaction Tax ('FTT'). The consequences of implementing an FTT are difficult to fathom, and we are only now seeing expert reports from the likes of professional services firms which detail what the impacts may be on the economies and financial services industries of EU member states. The original impact assessment and cost-benefit analysis did not take proper account of the costs, nor did it seek to understand the impacts of the proposals based on the lessons learned from other countries which have already implemented such taxes.

A further concern is that proposals change during the legislative process, sometimes introducing important new provisions. Where domestically the FCA or HM Treasury would be required to re-consult if proposals change in this way, the EU process does not appear to require, in practice, that further consultations or impact assessments are conducted. This results in certain pieces of legislation being introduced where the impact of the law is not properly understood or consulted upon. In the case of Solvency II, the legislative process has been highly inefficient and lengthy. The EIOPA impact assessment on the long-term guarantee package was not undertaken until at least 3 years after the original proposal was agreed. It is also noted that the length of time to reach agreement on Solvency II has meant that the proposal now fails to align with new developments in the market and in regulation, including coordinating with the work being undertaken by the IAIS around prudential requirements for globally systemically important financial institutions ('G-SIFIs').

10. What has been the effect of restrictions placed on Member States' ability to influence capital flows into and out of their economy, for example to achieve national public policy or tax objectives?

The Panel provides no comment to this question.

11. What may be the impact of future challenges and opportunities for the UK, for example related to non-membership of the euro area or development of the banking union?

The introduction of the Banking Union in the EU is likely to be an important new step, and will address particular concerns about breaking the link between Eurozone sovereign nations and the solvency of the Eurozone banking sector. While we agree with the UK Government's position that Banking Union is to be welcomed, but is not appropriate for the UK itself, we are concerned about what it will mean for the UK's influence in Europe in future. It will be vital that the UK voice is still heard in EU rule negotiations, and is not outvoted by the Eurozone block, considering the importance of financial services to the UK economy.

12. Do you have any further comments about issues in addition to those mentioned above?

None.