# THE FCA SMALLER BUSINESS 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 Smaller Business Practitioner Panel (the 'Panel') was established by the Financial Services and Markets Act (as amended) to represent the interests of practitioners from smaller regulated firms and provide input to the Financial Conduct Authority ('FCA'). The SBPP provides advice to the FCA on its policies and the strategic development of financial services regulation.

The Panel was pleased to discuss with HM Treasury its review of the EU balance of competence with regard to financial services at one of its recent meetings, and now wishes to further elaborate on some of the themes of the discussion in a written response.

We have provided our detailed comments below.

## 2. Executive Summary:

- The Panel recognises many of the benefits for UK Financial Services generally of the UK being in the EU, but also feels that direct regulatory costs are significant;
- Larger firms and wholesale market firms are more likely to feel the benefit and can absorb the costs better, than smaller retail-focused firms;
- Small firms particularly find challenge in following and engaging in the EU policy-making process, and in implementing changes from multiple pieces of legislation;
- The UK market is quite unique in the EU in its global nature, with also a highly developed domestic market. Applying rules across the EU may not always be appropriate given the underlying differences that exist between member states;
- Short implementation timetables are a particular concern for small firms;
- Regulation of retail financial services, especially at the detailed level, is more appropriate at the domestic rather than EU level, given national specificities and market maturities;
- Rules like CRD IV have made it difficult for the UK to balance competing objectives of financial stability and growth;
- Implementation of EU rules can be inconsistent across Europe, creating an unlevel playing-field;
- Often, it is preferable to have high-level EU rules with specific UK implementation, matched to features of the UK market;
- Restrictions on third country access may be impacting UK growth and international competitiveness;
- While it is appropriate to supervise some entities at the European level, the vast majority require supervision by domestic regulators who understand the domestic market;
- The level of the UK's influence on key debates is concerning for smaller firms, particularly if the UK is outvoted on important new rules.

**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 impact of EU rules for smaller financial services businesses has been significant, and increasingly the FCA as the UK domestic regulator is implementing EU rather than its own policy proposals. The rapid increase in Europe-led rulemaking in the last 10 years has particularly created substantial cost and time burdens on UK businesses of all types. However, it is understood by most that the majority of new initiatives arise from a genuine need to reform following the financial crisis, and many initiatives the UK government would have committed to in any case (e.g., G20 commitments), or the UK regulator would have called for if not started in Europe.

For small businesses, most recognise the overall benefits that the EU brings for the UK in terms of trade and opening up of the single market. The benefits however are not evenly spread across the different financial services sectors, with smaller wholesale firms benefiting significantly more than smaller retail firms, and larger firms generally benefiting more than smaller ones. Smaller businesses have only limited capacity to follow European negotiations, and limited compliance and business resource to implement the resulting requirements. The limited time and capital required to implement EU rules (as well as domestic ones) takes away from their ability to develop business propositions to meet customer needs. Equally, the cost of compliance with regulation as a whole is first paid for by the firm, but costs are ultimately passed on to customers through increased prices necessary to keep companies solvent and profitable. Firms are also negatively affected where timetables for implementation are short, or where multiple pieces of legislation have required implementation at the same time. There are several examples of where the time between receiving final rules (including technical standards) and UK transposition and implementation have been difficultly short (e.g., CRD IV).

While it is difficult for smaller firms to appreciate the direct benefit of certain EU policy proposals, the costs are directly felt by these firms. It is recognised however that many of the proposals have been designed to enhance financial stability or protect consumers, so are beneficial for the soundness of the market overall. The impact of much of the regulation provides greater benefit to larger firms, who are less likely to be impacted by the cost (as a relative proportion of their balance sheet or income / profit) and more likely to benefit from increased customer confidence and financial stability.

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?**

While overall the single market and European-led initiatives benefit financial services firms, for certain specific areas and certain issues the Panel believes that action at the domestic level would be preferable. For example, the investment advisory sector in the UK is substantially different from many jurisdictions' investment advisory sectors, both in terms of scope, customer base and structures. Equally, there is little commonality between the markets in financial advice in different member states, which makes creating a harmonised regulatory regime for the sector difficult. Each jurisdiction has a range of different products on the market (many of which are domestically focused), different tax regimes, different attitudes to saving and investment, different state provided benefits (e.g., pensions) and different levels of wealth. For this reason, retail financial advice is almost entirely domestic with very little cross-border advice given. While it may be possible to provide a harmonised European approach based on common principles, we feel that it is likely more proportionate and in line with the principle of subsidiarity if the design of the relevant regulatory regimes is left to domestic policy setters.

This is equally true in the wealth management sector. From Panel members experience, even where financial groups include operations in several different member states, each part of the business has to operate with a great deal of independence due to the widely varying markets in each jurisdiction (for example, the UK is substantially different from Sweden in terms of tax, pensions and the savings culture).

European-wide rules may also be less appropriate if the maturity of markets differs substantially, as is often the case. For example, life assurance product markets differ significantly between certain eastern European member states and certain more affluent western European member states. Issues that have been tackled by domestic regimes or industry self-regulation in matured markets may only just be arising and are yet to be tackled in newer markets. Single solutions to tackle the issues might not work for immature markets, and may be burdensome for markets which have tackled the problem with other solutions.

For more international and cross-border business, usually non-retail, there are benefits for smaller firms in having harmonised regimes – e.g., the UCITS regime is beneficial for UK fund managers. These allow firms to reduce their compliance costs by having a common, well designed regime that allows them to market their services to a broader range and number of investors across the EU. Where there is a common market already formed or forming in financial services across the EU, common regulation becomes more appropriate. There is a need still to ensure that even EU-wide common rules fit to international standards, to ensure the UK and EU can continue to invite trade and investment from the rest of the world.

It must be recognised though that, with regards to financial services, the UK market is unique in that it has both one of the world's largest global financial centres, and has a highly evolved domestic market. This is not the case for many of the other 27 member states, many of which have financial sectors that are much more domestically focused and more simplistic in their propositions. Even with regards to cross-border wholesale business, some aspects of the UK market are not the same as elsewhere in Europe. For example, bank distribution of investment funds is common in Germany and Belgium, but is much less prominent in the UK. Equally, the future risks and state of recovery from the EU-wide recession differ substantially from member state to member state. Of importance is that these factors are taken into full account when it is decided whether rules are created domestically or at the EU level.

It may be beneficial for the EU to undertake more non-legislative work, provided the benefits and consequences of the actions taken are appropriate, and do not substantially duplicate work that is already going on at domestic regulators (e.g., the FCA competition studies work), or coordinate self-regulatory projects that industry is already organising. It is likely that non-legislative projects would face similar problems as legislative ones if the solutions are not appropriate for European-wide application.

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

It is difficult to assess the impact that EU rules have had, and what would have happened without the current suite of EU-rules. We perceive that the focus of EU policy since the financial crisis has been predominantly on banking, and particularly designed to address prudential concerns. It is largely appropriate that this has been undertaken at the European level, to ensure coordination of banking standards, particularly across international banking groups. However, we believe being too prescriptive has made it difficult for the UK to implement a proportionate capital regime for small UK banks. The result has been that while tough European standards have helped the UK achieve its financial stability objectives for banks (and equally for insurers via Solvency II), there has been a resulting impact on economic growth. If the UK had tried to implement the Basel II requirements itself, it would likely have had greater consideration for the impacts to UK economic growth. Equally, a tough harmonised regime of particularly detailed rules has likely had an impact on competitiveness for cross-border businesses. For example, certain aspects of rules addressed at the asset management sector and others (e.g., the financial transaction tax) have resulted in firms moving out of the EU jurisdiction to countries such as Switzerland or into Asia.

The next area of rule development seems to be in consumer protection. While the rules will likely aim to provide a high degree of consumer protection across the single market, we reiterate our comments above that different consumer protection issues exist in different markets for a number of different reasons. There is a risk of EU rules creating unnecessary or inappropriate protections for consumers, and of EU rules running counter to, or duplicating, the regime that is being developed in the UK by the FCA.

A further concern for UK firms is the unlevel playing-field that is brought about when the UK asks firms to prepare early for the implementation of EU Directives, and other member states require only implementation on the date of application or do not enforce the rules fully after that date. For example, UK insurers have spent significant time, under pressure from the FSA and now PRA, to ensure they are ready for Solvency II. Many other member states are significantly behind on their implementation plans, and many insurers in the EU will likely not be subject to the full regime on 1 January 2016.

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 rule-making is particularly detailed and EU institutions have produced a significant volume of requirements which smaller firms particularly struggle to understand. As provided above, we can see the benefits of some high-level standards and requirements at the EU level, but often it is more beneficial for firms and consumers if domestic regulators are left some discretion to implement rules in a way which fits with features of local markets.

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

While smaller firms are less likely to be impacted by third country access issues than larger firms, for those firms who regularly deal with counterparties or service providers from outside of the EU, or non-EU investors and customers, these issues do raise concerns and impact on UK small businesses. The strict equivalence with EU rules that is increasingly demanded seems designed to give greatest weight to objectives of consumer protection and financial stability. The goals of competitiveness and economic growth are most negatively impacted by these requirements, with subsequent difficulties and limitations on UK businesses.

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

As above, we believe EU-level regulation for retail financial services works only if it is designed to tackle issues that are common to all markets. Where there is too much regulation, it is likely to create more problems or unintended consequences for UK consumers than if the UK was allowed to design its own regime with consideration of the specific features and issues in the UK markets.

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?**

Smaller firms have not been significantly impacted by the creation of the ESAs to-date, given that they are not supervised directly by them, nor contribute to their

costs. Smaller firms are only impacted to the extent that the capacity of the ESAs, beyond the previous level 3 committees, means that EU policy-makers are able to create more technical detail at the EU level rather than at the domestic level. While the ESAs work to date has been good, any move to concentrate greater supervisory or rule-making power at the ESAs risks creating a regulatory environment that is less attuned to the domestic market than one created by a domestic regulator.

**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 concerned that the UK's influence appears to be reducing, particularly given the importance of the financial services sector to the UK economy. It is important that the UK is using its resources to best influence the discussions and on the right topics – i.e., those that would most impact UK firms. One particular example is the deposit guarantee scheme directive, which was proposed with a pre-funding requirement on firms of 1% of deposits held. For smaller credit institutions (including building societies), we understand that this requirement would have accounted for around 50% of total annual profits, or if collected under an aggressive timescale could cause many institutions to breach capital requirements and ultimately fail. We understand the UK sought to push back on this requirement, and has achieved some success. If it did not succeed, it would likely have had significant impacts for the UK. The rules are still likely to be challenging for small firms affected, once implemented. If similar rules were considered only at the UK level, they would be unlikely to include pre-funding (UK experience is that this has never been necessary, and does not pass a cost-benefit assessment).

**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?**

For smaller firms, EU policy-making and consultation processes appear particularly opaque. Such firms do not have the resources to directly engage in contributing to the policy-making process, and rely heavily on trade bodies and the UK Government understanding the needs of smaller businesses. We would welcome any move to make the process more transparent and for more consideration being given to the potential costs to all stakeholders – consumers, taxpayers, and firms both large and small.

**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 Panel provides no comment to this question.

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

None.