Investment Management Association

By electronic mail: Balance of Competences Review Team, HM Treasury
(balanceofcompetences@hmtreasury.gsi.gov.uk)

17th January, 2014

Dear Sir/Madam,

The Investment Management Association represents a major part of the UK financial-services industry. Our members, who compete for the ability to pick investments that will benefit their customers, include independent investment managers as well as the arms of retail banks, life insurers and investment banks, together with the managers of occupational pension schemes. They are responsible for the allocation of over £4.5 trillion of assets (as at end 2012), invested on behalf of clients from around the world. Clients gain access to the services of investment managers through: funds authorised for retail distribution by the FCA (subject to regulatory conditions); 'institutional' funds (eg, pensions and life funds); private client accounts; and a wide range of other pooled investment vehicles. In relation to 'authorised' retail funds in particular (ie, unit trusts and open-ended investment companies), our members represent 99% of the money under management.

The IMA's purpose is to ensure investment managers are in the best possible position to:

- Build people's resilience to financial adversity
- Help people achieve their financial aspirations
- Enable people to maintain a decent standard of living as they grow older
- Contribute to economic growth through the efficient allocation of capital

Our response to selected questions raised in the public consultation is included as an annex to this letter. Please do not hesitate to contact me on 020 7831 0898 or at Richard.Metcalfe@investmentuk.org should you wish to discuss any points in more detail.

Richard Metcalfe,
Director, Regulatory Affairs (Institutional and Capital Markets)

65 Kingsway London WC2B 6TD
Tel:+44(0)20 7831 0898 Fax:+44(0)20 7831 9975
www.investmentuk.org

Annex – IMA response to specific consultation questions

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 Investment Management Association (IMA) is a UK organisation with an international 'footprint', reflecting the UK's global standing in the field of asset management. As such, EU rules are of great significance to the IMA's membership – providing a basically positive framework for business, not just across the European Union but even globally, as well as purely within the UK.

The international nature of the UK's asset management business – the business of picking financial investments on behalf of others – is made up of various elements which currently work well in and from the UK. In concrete terms, this not only means a mix of firms, some of them headquartered outside the UK (in other parts of the EU and elsewhere); it also means customers from outside the UK as well as within it (again, some within the EU and some not). In short, IMA members maintain the UK as a truly global centre of excellence in fund management and a major financial services export. Moreover, the investments that fund managers make on their customers' behalf may of course be worldwide – not just in the UK or the rest of the EU.

Regulation of this business has two particularly prominent aspects. The first is the protection of retail customers; the second, effective functioning of markets, especially the wholesale markets to which asset managers in effect provide access for retail customers. (Capital requirements also feature, though these should by rights remain limited in size and scope, since investment managers do not carry risk on their balance sheets of the size that makes banks systemic.)

Each type of regulation in its way has contributed to a harmonised market place across the EU, but especially the legislation on the operation of financial markets and on collective investments. This has provided tangible benefits, albeit ones that firms cannot easily quantify, in the form of the obvious advantage of being able to do more business from the same platform. The same firms do, however, express concern about the pace and extent of newer legislation, some of which even calls into question the ability of the EU to support the broadest range of leading financial markets.

The economic significance of asset management – for the UK as a whole, as well as for individual customers – is already high. Such collective and institutional investment has increased, not just in the UK but worldwide, in a secular trend over the past half century or so. Now, the UK is the most significant centre for investment management in the European Union, accounting for some £5 trillion sterling of assets under management, out of a total €15 trillion (or ~£12.5 trillion sterling) for Europe more broadly. The UK (which here means Edinburgh and other centres, as well as London) is the second largest centre for asset management in the world, after the US.

Investment management also appears likely to grow. Investment management can support customers' long-term savings objectives (notably retirement planning) and also shorter-term financial objectives. We expect further growth in asset management, as individuals are faced with more of the responsibility for saving, against a backdrop of financially constrained governments.

By way of context for our remarks in this response, we do not see the current Review (of the Balance of Competences) as the place to narrowly assess the detail of individual pieces of EU regulation, current or prospective; or even the process by which some of it has been generated, though we do in practice have specific concerns about aspects of both the laws and their genesis and believe that a more considered approach to outcomes would be desirable.

We also remain concerned that, in practice, the institutional balances themselves might lead to outcomes which are bad for the EU. But this is arguably more a question of how the legislative model is currently operating, rather than the concept. It may be that part of the way to improve it is even greater, more consistent, strategic engagement by the UK with EU partners on financial services dossiers – not just the direct interaction with the legislative process.

The institutional arrangements clearly embed an incentive for the European Commission to produce ever more legislation, as part of its raison d'être. There have been periods where this has been tempered but the past five years are not one of those periods. Underlying this is a tension between regulatory philosophies: put crudely, these are: (i) permitting anything that is not specifically barred; or (ii) barring anything that is not specifically permitted.

Also, since 2008, there has been a loud – if not always coherent – public policy debate about the role of financial services, much of it framed as a question of how they inter-relate with the 'real' economy. From the IMA's perspective, this debate is somewhat artificial and unnecessarily adversarial.

The primary question, however, is whether the institutional model is, in principle, the correct one. In the IMA's view, while the manner in which certain EU institutions operate in practice may sometimes leave something to be desired, it is hard to argue with the logic of a balance of competences between Member States, Parliament and Commission-plus-ESAs.

The sheer amount of new legislation – and the haste with which some of it was proposed – has been a burden on members. While legislation after 2008 may have been inevitable, too little account was taken of the need for firms to plan ahead and to create related infrastructure (notably IT). It is, however, hard to suggest much apart from 'better' operation of the existing legislative system. The main weaknesses are in the rigour (or lack thereof) in cost-benefit analysis; and in the failure to sufficiently respect the existing role of the European Supervisory Authorities.

Please see the IMA website *for more information on the Association, its membership and its purpose.*

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?

Regulation at EU level, such as the Market Abuse Directive as well as MiFID, helps (wholesale) markets to function fairly, promoting confidence and thereby ultimately serving the broader economy. Combined with measures to protect retail customers from unfair practice, one has a common EU framework that supports business across a single market.

The temptation more recently, however, appears to have been that 'more' regulation ensures better outcomes and that 'more' must be expressed as new pieces of legislation. This phenomenon is not unique to the EU, but that does not make it right. For example, to introduce requirements for clearing OTC derivatives without first establishing how these obligations will work for a wide range of end-users strikes us as ambitious at best.

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

In certain areas connected to financial services, notably pensions, EU objectives have sometimes sat uneasily with one and other. For example, consumer protection ('safety') is emphasised heavily in the Commission's 2010 Pensions Green Paper. While an emphasis on consumer protection is perfectly logical per se, it can be dangerous if taken to an extreme and in isolation from other considerations. Safety should manifestly be balanced with the goals of adequacy and sustainability, which will almost certainly entail some degree of risk-taking. Yet the objectives of adequacy and sustainability could be made far more difficult to achieve in an environment where a shift to (low-return) 'safety' results in sub-optimal long-term investment decision-making. Indeed, one could argue that a regulatory bias towards de-risking – which tends to encourage increasing exposure to fixed income instruments, even in a period of historically low interest rates – is anything but a position of safety.

In a similar vein, a critical concern for UK DB pension provision in the last 18 months has been that the IORP review could result in approaches that damage the sustainability of such arrangements, all in the name of helping savers.

By way of background to the points above on long-term savings, we note the constraints on government finances that have clear and strong implications for the extent of their capacity to ensure retirement provision for their citizens.

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?

The volume and detail of EU rule-making can be problematic in accumulating overlapping requirements. Firms particularly mention a multiplicity of reporting obligations across the EU, each of them challenging in their own right.

Please also see comments above, under question 2 – particularly the second paragraph; and below, under question 7.

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

As highlighted above, the UK investment management industry is global in nature. As such, third-country rules are important. There were troubling signs during the MiFID negotiations of a protectionist approach to financial services in the EU, which we believe is ultimately counterproductive. We accept that this is a challenging area, where other jurisdictions may adopt approaches that put the EU in a difficult position and where the background may be one of unequal access to markets. Nonetheless, the starting presumption should be that global financial markets benefit all. They allow greater investment into the EU as well as providing valuable flexibility for investment management firms based in the EU to delegate (with appropriate checks and controls) to local experts in non-EU markets.

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

The end-customers of fund managers are ultimately retail (some of them served directly, through collective investment schemes; some indirectly, for example via pension schemes). These customers are rightly afforded greater safeguards than market professionals, and this is reflected in regulation of certain products (in the case of collective investment schemes, under the UCITS legislation, for example); as well as in the rules more generally on the selling of financial products and services (viz, MiFID). A common EU approach here is an essential element of a single market.

It is difficult, though, to judge consumer protection in terms of 'more' or 'less' regulation. The EU retail funds industry is already heavily regulated and this is broadly welcomed by the industry itself. This regulation translates into strong structural safeguards (notably, arrangements for holding customer assets separately from those of the manager) and harmonised disclosure requirements. Because this combination of measures offers a robust approach for consumers, it has the desirable side-effect bolstering the UCITS brand, not just within the European Union but also overseas. (*See comments below, under question 12.*)

The IMA further believes that these benefits could apply more broadly. Aspects of the disclosure regime, such as the methodology for standardisation of charges and the presentation of risks in the 'Key Information Document (KID)', could usefully be extended to other investment products, via the PRIPs initiative. While full harmonisation in areas such as pensions would be challenging, it should not be the case that consumers across the EU are faced with inconsistent standards within the financial services industry.

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?

While ESAs are doing more work than ever, paradoxically their role appears to have been undermined, which is unfortunate. In our view, it is a recipe for trouble if detail is routinely locked into primary legislation. We note that such an approach is a significant departure from the widely supported Lamfalussy blueprint.

Examples of excessive detail exist in the AIFMD, which incorporates in measures on VaR calculations and on retention standards (in relation to securitisations) quantitative provisions which are arguably adequately better covered elsewhere, in ESA measures. It is also debatable whether the changes proposed to the UCITS regime by the Commission in its 2013 Green Paper truly merited a new piece of legislation, rather than technical 'fixes'.

Moreover, the potential for the work of the ESAs to become a political football for the Commission and Parliament appears to be high, based on experience with technical standards under EMIR specifically and, more generally, the ease with which the Commission can choose to ignore ESA conclusions. It is also unsatisfactory that the time available to ESMA to develop technical standards was eroded by delays in finalising EMIR. This is particularly disappointing, since the ESAs' work does in principle provide an important check on the legislative process, incorporating as it does genuine consultation with industry.

As regards supervision rather than legislation, the gradual shift towards more power for the ESAs is something that requires careful scrutiny. The system of passporting is tried and tested and, while we strongly support the role the ESAs can play in promoting consistency and enforcement of EU legislation, we believe this will be at its most effective if it is backed by healthy national supervision, which can in principle cope better with the subtle differences between Member States and their financial markets.

Somewhere in between legislation and supervision lies the issue of forebearance, which under the EU system is orphaned. In fact, once a piece of legislation comes into force, the EU system as currently operated is conspicuously and unhelpfully lacking in any way to create legitimate exceptions – whether temporary or permanent – or to amend legislation quickly. Review clauses go only a very short way to addressing this and there is a strong case for relying much more on framework Directives, to avoid unnecessary rigidity in the system.

Unless and until this issue is satisfactorily resolved, it would be preferable in our view not to extend further the ESAs' powers.

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 basic framework for EU financial services legislation appears to be consistent with the approach of the UK, in that it sets out key principles for conduct of business, distinguishing between levels of expertise in the market and envisaging a major role for proportionate supervision. It appears to be well understood that i) there are clear advantages to engaging effectively in EU legislation and ii) a key part of effective engagement lies in the alliances that may be formed with other EU stakeholders.

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?

We are not completely satisfied that the democratic due process is always properly respected. Impact assessment tends to be high-level and can be driven by dogma, in a manner which threatens to bring the whole process into disrepute. Greater economic cost-benefit analysis is important, as is the preliminary application of common sense (for instance, considering what the real impact of a financial transactions tax would be). A measure such as the Short Selling Regulation is in danger of punishing markets for the messages they convey, when the underlying problem lies elsewhere.

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?

NA

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?

NA

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

As alluded to above (under question 1), from the perspective of capital and services flows, the importance of European markets as sources of export income for UK-based asset managers can be seen in a number of ways. IMA data suggests that almost £1trn is managed in the UK on behalf of European clients. This ranges from retail savers using investment funds such as OEICs and SICAVs through to institutional clients such as pension funds and insurance companies. The UCITS framework in particular has established a pan-European fund product set and an accepted brand that has also served as a springboard for fund exports internationally, from Asia to the Americas.

At the same time, while the UK as a domicile for funds has been eclipsed in growth terms by other jurisdictions, notably Ireland and Luxembourg, there is significant delegation of the asset management function to UK-based managers. An estimated £720 billion is managed for overseas-domiciled funds.

With changes to the UK tax regime now making it more attractive to domicile funds (as well as manage assets) here, the UK 'Investment Management Strategy' will hopefully contribute to greater growth in this area and enhance the UK's role as a world-leading asset management centre

Serving overseas clients is not simply a matter of the scale of the UK as a financial services centre. It is also about the ability to develop new expertise for export. One example in recent years has been the development in the UK of an 'exportable' product set for Liability Driven Investment (LDI, which better seeks to match scheme asset and liability profiles for Defined Benefit pension schemes). There has been some success in 'selling' this product set in the US.

Within the EU, with a shift towards Defined Contribution (DC) schemes likely to accelerate in coming years, there will be opportunities for the UK asset management (and pensions) industries to play a role as welfare systems evolve across the EU.

Meanwhile, there is a further challenge for the EU: to develop more of a role for market-based finance, as distinct from bank lending. It is known that the EU is heavily reliant on the latter, making its economy unnecessarily sensitive to bank failure and creating potential bottlenecks; and, at the same time, an incentive for high leverage within the banking sector.

We support concerted efforts to develop market-based finance further. To clarify, we do not argue that market-based finance can prevent financial crises. (The US economy, which relies much less extensively on bank lending was no less immune than other parts of the world in 2008 and beyond.) But it is equally clear that heavy reliance on bank lending has its disadvantages too. In fairness, the 2008 crisis had underlying causes (relating notably to property-linked credit) which affected *both* types of finance, just as both may be affected in future by some common factor. But market-based finance provides a relatively transparent alternative to the use of bank balance sheet. Moreover, bank balance sheets will remain capital-constrained in future, because of secular changes in regulation and in risk-appetite.

Clearly, a genuinely Single Market (without constraints on business across EU MS borders) goes in the direction of supporting greater market-based finance. However, this will only be as good as the markets' fundamental ability to function for the benefit of their users. Collective investment funds bring economies of scale to retail investors, especially when those funds can be consolidated in one domicile (rather than duplicated, with the attendant duplication of costs, in a second jurisdiction, and then a third, and so on). Yet those same funds are penalised by rules that unnecessarily constrain their ability to transact in size, because such orders are vulnerable to predatory trading from those taking advantage of the information they can glean, because of what are (we presume) well-meant rules on pre- and post-trade transparency.

Another angle here is the contribution of market-based finance, particularly in areas such as infrastructure, against a backdrop of constrained government finance and capital-constrained banks. In this area, the potential clearly exists for asset managers to play a major role, precisely because they are *not* banks and so do not take assets and liabilities onto their balance sheets (which is of course what makes those banks systemically significant). IMA firms do not generally take their clients' savings onto their own balance sheets. They do, however, direct those savings into productive use, typically via securities markets and related instruments.

The importance of a single EU market is not just about benefits to the financial services industry and an associated contribution to UK balance of payments and the economy. It extends to UK savers and investors, in the form of access to a broad range of products and expertise. Ultimately, greater scale in consolidated fund ranges also feeds through to more efficient, lower cost investment vehicles. There may be a moral here for the pensions debate, too. There might be particular benefits from the emergence of tax transparent funds, serving highly diverse individual European member state fiscal arrangements.