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Balance of Competences Review – Single Market: Financial
Services and the Free Movement of Capital

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HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Sent by email to: balanceofcompetences@hmtreasury.gsi.gov.uk

Dear Sirs

Call for evidence for 'The Review of the Balance of Competences – Single Market: Financial Services and the Free Movement of Capital' report

We welcome the opportunity to engage with HM Treasury on this Call for Evidence regarding the EU's competences in the field of financial services and the free movement of capital.

By way of background, Baillie Gifford & Co is an independent investment management firm based in Edinburgh. The firm is a private unlimited liability partnership established under the laws of Scotland and includes a group of companies which are authorised and regulated by the FCA. One of its subsidiaries, Baillie Gifford Life Limited is additionally authorised and regulated by the PRA. The Baillie Gifford group provides only one product to its clients, fund management. Whilst different legal structures have been established to accommodate various different client types, the essential services remain the same.

We employ about 785 staff and manage about £105bn, almost wholly on behalf of institutional clients in over 24 countries, 60% of clients are from outside the UK. So we represent a very strong example of the global nature of asset management businesses and the potential for the UK to be competitive on a global scale.

I am the partner responsible for Legal and Compliance. A number of years ago Baillie Gifford recognised the importance of engaging more directly in European policy making, as the Commission, Parliament and Council devoted it's proposals for reform of the existing single market regime, primarily in response to the issues arising from the credit crisis. As a consequence, the firm spent more time and resources and hence cost on this area, given the potential for impact on our strategy or business structure. Our most intensive experience has been with the Capital Requirements Directive, given its potential impact on our capital structure, remuneration and governance. Also the Alternative Investment Fund Managers Directive, given its impact on a number of long standing investment trust clients.

We welcome the opportunity to engage on this topic and have provided feedback to the relevant questions posed below:-

- 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?**

They either have a direct effect by the EU's use of regulation to implement a measure, eg Capital Requirements Regulation, or indirect effect, where it is for UK competent authorities to transpose EU primary legislation. Much of the focus over the last 6 years has been on restoring confidence and stability within the market. Although focus has been on banks and other institutions, asset managers have also been affected, and in some cases disproportionately.

The agenda pursued within the EU has arguably been too ambitious with a large number of significant changes, which creates the risk of poor legislative outcomes, by virtue of the volume and a slower pace of change due to the capacity to process all the requirements. 6 years on, we are not yet through many of the changes identified in the original Delarosiére report. We believe that the market would benefit from a phase of consolidation, helping regulatory measures settle and regulatory focus in the EU moving to supervision of implementation by competent authorities to ensure a level playing field and also a return of focus on investor protection.

Examples of the pace of change, are UCITS where we had the original directive 25 years ago, but have seen three reforms of it in the last 5 years. AIFMD is another example where the scope of level one measures was arguably drawn too widely impacting a large number of funds and firms which were not within the original focus of the regulatory objective.

- 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?**

At present the balance of powers between the EU and UK is arguably confused. We have the dynamic of the scale and influence of the UK market in financial services, being dominant in many areas in an EU context, and yet EU policy being developed across the 27 member states, each with a potential impact on the regulatory outcome. Given the scale of the industry the UK authorities believe it appropriate and necessary to drive their own policy making agenda, but at the same time requires to implement and influence EU policy making. This can lead to an inefficient market for firms, where we in effect have to dig up the road twice. For example the outcome of RDR in the UK is unlikely to be reflected in the EU MIFID regime given the differing market structures. Likewise the current FCA review of dealing commission, and how this will fit with wider EU and global standards.

This balance of powers leads to increased complexity and potential cost to firms.

- 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?**

As said above, there is too much volume at present. We have also noted a trend for greater prescription, by the use of Regulation, and also detail in terms of level 2 measures and also ESA standards and guidance. Their aim to achieve greater harmonisation across the EU leads to inflexibility and the application of standards without taking on board the nuances of a complex market. For example, the recent debate around delegation within AIFMD and how the level 2 measures can be implemented by competent authorities in a way that avoids material impact to global asset management models.

We also believe there is overlap between ESA's with asset managers being affected by EBA on prudential, governance and remuneration matters as well as ESMA, but the EBA's focus is clearly directed towards banks. ESMA is also a broad church, being a "securities" authority, and thus asset managers are left somewhere between these bodies. Likewise the relationship between the Commission and ESA's is unclear at level 2. We saw this in AIFMD where the ESMA advice to the Commission, which had been consulted on heavily by the industry was not followed in material areas, without any further consultation or transparency.

- 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?**

The prospect of a single EU regulator seemed remote 10 years ago, but now we have the increased powers of the ESA's. However do they have the resources to achieve their aims. It appears the focus has been on new rules and volumes of guidance (look at the work plans for the EBA and ESMA for 2014!). Yet, there is limited focus on supervision or review of the activities of each competent authority and its implementation of the volume of change. There is a risk of form over substance, with the end outcome of no better a deal for the EU citizen in terms of investor protection or market confidence.

There is the risk of the ESA framework being caught in the middle ground, with the powers but not resources to achieve objectives, and the resources but not the powers sitting with local competent authorities.

- 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?**

Our experience of the EU legislative process is that it involves a large number of actors, and hence complexity in developing legislative measures. For stakeholders this presents a challenge in terms of resourcing for this multi faceted process, but also uncertainty in regulatory outcomes, given the politicised nature of the debate. Examples are the discussions around bonus caps and remuneration, and also capital standards for banks. Rational debate and argument needs to be retained with objective, and fact based inputs leading to unemotional and logical regulatory outcomes. The current process does not appear to always accommodate this.

It is also potentially too slow. Responses to the credit crisis are still being debated or developed, and yet in many cases the issues and risks have moved on.

In summary, we welcome HM Treasury's interest in this area and hope that we will have the opportunity to continue engagement on the EU's competences in the field of financial services and the free movement of capital. The agenda pursued within Europe has arguably been too ambitious, with a large number of significant changes. This creates the risk of some poor legislative outcomes, due to the volume of change being processed. We hope that the pace of change will abate and there will be some consolidation and reflection. We would appreciate it if you would keep us informed of any future events and opportunities to discuss this topic.

Yours faithfully

Graham Laybourn
Legal & Compliance Partner