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HM Treasury's Review of the Balance of Competences

Single market: financial services and the free movement of capital

A response from the Wealth Management Association[1]

Introduction

The Wealth Management Association represents 182 Wealth Management firms and Associate Members that deal in stocks and shares, and other financial instruments for the retail sector, comprising individuals, trusts and charities, under formal contracted relationships. They offer a range of services across a spectrum from execution only through to full discretionary management on behalf of 4m UK customers.

EU rules on financial services have a significant impact on our member firms and we welcome this opportunity to respond to HM Treasury's consultation on the Balance of Competences between the UK and EU institutions in financial services.

We have set out below our answers to the questions, but first wish to highlight the often lost importance of distinguishing in both legislation and regulation between the retail and wholesale financial sectors. We make the point in our main response (especially in answer to Question 2) that the retail financial market in Europe is fragmented, national and divided by all sorts of cultural, fiscal, linguistic, historical and other factors from the single market ideal that dominates the wholesale sector. This should lead to clear differences of approach to retail and wholesale, but all too often retail firms get swept up in attempts to impose EU-level one-size-fits-all solutions appropriate for a single market wholesale régime onto retail products and services.

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[1] The Wealth Management Association (formerly the Association of Private Client Investment Managers and Stockbrokers - APCIMS) is a trade association representing 182 Wealth Management firms and Associate Members. With formal contracted client relationships our firms deal in stocks and shares and other financial instruments for individuals, trusts and charities and offer a range of services across a spectrum spanning execution only through to full discretionary services.
Our member firms act for over 4 million private investors and carry out around 20 million transactions a year in the marketplace. Our members also manage £600 billion of wealth in the UK, Ireland, Channel Islands and Isle of Man, operate across more than 580 sites and employ approximately 32 000 staff.
Our aim is to ensure that any changes including operational, regulatory, tax and other business matters across Europe and the rest of the world are appropriate and proportionate for our wealth management community and, most importantly, their clients.

This is a major problem and needs to be addressed by differential approaches to the two market sectors by national governments and EU institutions alike. An encouraging start in the life of the FCA has been made by the introduction there of a specific private wealth management regulatory unit, and we would like to see this differentiation emulated at EU level and in other member states.

We note in the context of the retail/wholesale division that the Financial Services Action Plan (FSAP) in the first years of this century had as its objectives:

- to create a single EU wholesale market;
- to achieve open and secure retail markets; and
- to create state-of-the-art prudential rules and structures of supervision.

The absence of any "single market" reference on the retail side has the effect of acknowledging the differences between wholesale and retail markets that we highlight here, and we would like to see these differences embodied in relevant different approaches to the single market concept adopted in the EU.

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?*

Brussels sets the general approach to and principles of regulation for WMA firms as well as the detailed rules that they must follow. These impose huge costs on firms especially where there are regular and occasionally frequent changes to systems and processes. KPMG, the accountancy firm, reported last year that wealth management firms spend between 10% – 20% of their turnover on regulation[2]. For agency businesses (an intermediated model that really only exists in the UK and Ireland) this could equate to up to 50% of profits, so that complying with the rules halves the wealth management sector's profitability. This hardly seems fair given that the wealth management industry did not play any role in the banking scandals and its clients were victims of, rather than participants in, the financial crisis – and it is a situation that is very likely to be unsustainable in the longer term.

The costs placed on wealth management firms are a direct result of the lack of proportionality in developing EU legislation, especially the responses to the financial crisis. Proposals are often too wide in scope from the outset. For example, MiFID/R[3] is a form of jumbo legislation covering a plethora of issues in both retail and wholesale markets, yet the arguments for and against the various proposals are discrete and probably better handled separately.

Other proposals extend beyond the original scope as a result of amendments made throughout the process by the European Parliament and the Council – one example is the amendments to the scope of the PRIPs legislation[4] to include non-packaged

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[2] KPMG (2012) '*UK wealth management at its tipping point?*', [online], http://www.kpmg.com/UK/en/IssuesAndInsights/ArticlesPublications/Documents/PDF/Market%20Sector/Financial%20Services/UK_Wealth_Management_Report_open.pdf] (Accessed 16 January 2014).

[3] The proposed Regulation on markets in financial instruments and amending Regulation [EMIR] on OTC derivatives, central counterparties and trade repositories, Presidency compromise text dated 15 April 2013.

[4] The proposed Regulation on a new Key Information Document for investment products, European Commission proposal dated 3 July 2012 and subsequent MEP amendments.

products such as corporate bonds. When such changes to scope are made, there appears to be little consideration of the impact on wider financial markets or whether the new rule would actually benefit retail consumers. Indeed, earlier proposals to apply legislation designed for institutional markets to retail markets via MiFIR Article 28a (included in the European Parliament text only, and thankfully now dropped) would have forced all retail transactions in equities through a clearing house and caused significant detriment for UK retail consumers of financial services by destroying the Retail Service Provider model which handles 94% of UK retail equity deals and protects retail investors from the volatility of institutional markets. In fact, the 20m annual trades passing through the UK's RSP system benefit from full client segregation right through to settlement; clearing and netting would undo such segregation.

We note that there is a tendency for the European Parliament to use the amendment process as a 'catch-all' to pass legislation outside the original scope and objectives of the original proposal, often leading to unwieldy proposals that struggle to get passed into law; PRIPs has been a good example.

Overall, there is an overwhelming predominance of 'bank-think' across EU institutions that creates a potentially damaging one-size-fits-all mind-set and targets all firms as if they were banks – and often large systemic banks at that. But many financial services firms, such as the wealth management firms of the kind in the WMA community, are not banks and face different risks and problems. In particular, they do not take deposits and do not undertake credit risk, and they cannot use client money for their own purposes. They act only on an agency basis and are controlled by the client asset segregation rules. They should thus not be treated as banks and a much higher level of differentiation and proportionality is required.

This tendency reflects the majority continental structure of financial business in the EU – the *bancassurance* model run by universal banks whereby retail consumers purchase the vast majority of financial products via their bank – which is not replicated in the UK. Here, the industry structure is much more specialised and fragmented into firms built up to deal with specific types of client or market need. There is no equivalent in the EU to the WMA or the firms that make up its membership, where many firms are small retail brokers employing few staff. Those who frame and pass legislation at the EU level do not think in terms of this country's requirements and instead we have a constant battle to fend off legislation for other sectors which has potentially damaging consequences for ours.

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 language in this question reflects a tendency to be preoccupied with wholesale, cross-border markets and firms in the EU. It is however very important as stated in our Introduction to differentiate clearly between wholesale and retail financial markets in the EU, and their different positions in relation to considerations of EU-wide legislation and cross-border business.

The wholesale markets are characterised by inter-professional activity; large firms operating in multiple jurisdictions; on-market and off-market dealing with no regard for language differences or national frontiers; product similarity (an equity is an equity, wherever purchased); massive funds transfers between entities in the same group; universal capital controls; and a primary concern with home state prudential regulation as opposed to host state conduct of business regulation. The majority of transactions are dealt by the firms as principal deals.

Retail markets, on the other hand, have very different characteristics. Retail financial services are national in offering, not EU wide; there is very little retail cross-border use of financial professionals; and retail investors tend to stay within their cultural origins and language groupings when selecting professional help and advice. The domestic professionals will often look for the best investments to suit client needs across a wide global reach and therefore need access to global markets, but still acting as the agent of the client. Retail market culture also varies markedly between member states; for example, equity and bank lending cultures create distinctive and different retail investment patterns and local rules framed around them. National tax laws also induce local retail behaviour with regard to product selection: they bias the market in favour of national rather than EU-wide developments.

Retail investor behaviour thus differs between member states and, as a direct result of differences in culture and tax law, preferred products can be quite different from country to country. In fact, due to tax laws, there are products (such as ISAs and SIPPs in the UK) which are not transportable across borders between different EU countries.

Further, UK agency law (mentioned in our response to Question 1) provides a model whereby the retail financial intermediary acts as agent "on behalf of the client" without taking a principal position in on-market transactions. There is no clearing requirement in the overwhelming majority of these transactions. Of the other EU jurisdictions, this specific situation is only replicated in Ireland.

Against this background, the single market only works for retail savings and investment when on the one hand there are common experiences of the retail operation rather than identical rules and laws, while on the other local fine tuning to suit local conditions takes place. This is completely different from the operation of the wholesale markets.

Whether legislation is better made at national or EU level depends greatly on this retail/wholesale distinction and on the financial market and sector being considered. In cross-border, institutional markets EU-wide legislation can generate real benefits by implementing consistent rules across EU Member States. But this is not the case in retail markets, where national rather than pan-European approaches are more appropriate, reflecting the fragmented characteristics and impact of national jurisdictional control described above.

All of this points to the use of Directives for retail markets legislation, rather than Regulations, to properly address the balance of convergence and subsidiarity and allow different local cultures to flourish. It also suggests that in the retail markets a different structure of EU legislation, based much more on principle rather than prescription, should be used. We provide more detail in our response to Question 6 below.

Even when legislation is effected via Regulations, there are sometimes issues as to how different Member States implement them. Such differences can clearly impact the efficiency of financial markets and hence economic growth. We elaborate a little more on this in answer to Question 4.

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

If G20 agreements are implemented faithfully then EU rules do indeed help in achieving these sorts of objectives. However, EU rules often interpret or go beyond the G20 and in these circumstances in particular they can – and do – have a detrimental impact on both growth and competitiveness. We have already outlined in response to Question 1 above the enormous cost associated with complying with EU rules faced by wealth management firms. This has clear consequences for the EU's competitiveness as a whole. Indeed, the impact assessment for the proposed Financial Transaction Tax (FTT) openly acknowledges that it is anti-growth, meaning that EU rules may sometimes be implemented without regard to their impact on growth or the EU's competitiveness.

The FTT is also a good example of the way that in recent years financial services legislation and regulation has been used more as a political football to gather votes than to implement reasonable and effective mechanisms to protect consumers, improve competitiveness or aid growth. This situation has led to poorly targeted, excessive regulation that does not achieve its objectives but reduces both growth and competitiveness within and without the EU. Overall, the EU shows strong inward looking tendencies meaning that competitiveness vis-à-vis the rest of the world is ill-considered, if it is considered at all: policymakers would do well to think more like exporters than politicians in this regard.

Within the UK, firms' competitiveness can also be impacted by the UK's tendency both to front-run and gold-plate EU proposals. One recent example of front-running has been the implementation of the Retail Distribution Review (RDR) ahead of MiFID/R. This has led to increased costs for UK financial services firms to accommodate changes to implement the RDR; and although a national override is built into relevant parts of the MiFID it remains unclear whether the MiFID/R will have to be implemented in a way that forces further expensive change on firms away from the RDR and towards MiFID requirements. We believe that UK institutions should think carefully before front-running other EU proposals – and that they should also have a strong case to make when gold-plating EU rules for reasons other than to properly address the balance of convergence and subsidiarity and allow different local cultures to flourish.

Of the various objectives listed, we believe that financial stability is by far the easiest to achieve: systemically important financial institutions (SIFIs) tend to be similar and can thus be easily grouped together for legislative purposes meaning that the EU can – and should – achieve a lot in this area. Whether consumer protection is best dealt with at EU or national level depends at least in part on what consumers are being protected against; we have provided more on this in response to other Questions, notably 2 and 6.

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?*

In general the volume, detail and quality of EU rule-making in financial services is variable. There are numerous problems.

First, the whole system is a jumble of different institutions, concepts and documents with different and sometimes obscure powers assigned to each, which makes it hard to define "rule making" at EU level. Does this refer only to the rules or "Regulatory Technical Standards (RTSs)" made by the European Supervisory Authorities (ESAs), which bind on national supervisory authorities and not on firms or markets (except where the European Securities and Markets Authority, ESMA, has regulatory and supervisory power over credit rating agencies)? Or does it include the legislative output from the European Parliament, Council, and Commission, the Level 2 text of which in particular has many of the characteristics of rules? There are also other documents including Guidance from both the Commission and the ESAs that in some circumstances carry the weight of rules but in others do not. There is often a good deal of ambiguity and confusion about these, not least because at the national level it is not clear how they relate to local rules for compliance purposes.

The distinction between Regulation and Directives also causes difficulties. As made clear elsewhere in this paper, Directives are greatly to be preferred for retail financial services markets because the need to pass legislation through national Parliaments with local regulatory input tends to ensure that interpretations are in line with local market practice and consumer knowledge in a particular country. This means that the resulting rules make sense to market participants and carry credibility there. However, the impact of Regulations locally has yet to be fully understood because they direct local supervisors in ways that may conflict with local rules or in language that is not commensurate with local rules. This leaves supervisors and firms uncertain about what they are supposed to comply with. Indeed, Regulations and ESAs are too distant from retail markets, which are characteristically local rather than cross-border in nature, to be able to do anything meaningful in relation to them. Certainly what may be right in one retail market may not be right in another so any attempt by an ESA to enforce an EU-wide Regulation affecting the retail sector is bound to have at most partial success. A good example of this was the Regulation related to short selling: in the UK, there are no systems that distinguish between an unsettled sale and a true short-sale.

The upshot of this is that there are too many overlaps and layers of bureaucracy involved in EU rule making, insufficient clear lines of accountability, and too much ambiguity about what is the more important rule with which to comply to have clarity of rules. And, as a result of the confusion of structures and processes, there is a strong tendency for there to be an excess of EU rule-making rather than good quality and well-targeted rules that actually improves the quality of markets and protects investors.

Second, the EU is made up of 28 different member states with different stages, styles, and sizes of financial markets, as well as different histories and cultural traditions. All are involved in legislation and rule making, which can make it difficult – and in the retail sector we would contend almost impossible – to produce a single set of rules suiting all the EU market: what is too much detail and volume for one country may be too little of both for another. In the retail markets, we believe that the focus should be on principle at the EU level with detailed rules made locally; if there is an insistence on EU rule-making it should be in the form of Directives to allow for variations in local implementation to suit local circumstance. One size cannot fit all in both an effective and an efficient manner.

Third, the knowledge of the drafters: in general, the European Commission takes steps to ensure that its staff has sufficient expertise in specific areas to draft relevant consultation documents and legislative proposals. It also gathers evidence from the markets, takes advice from external experts, and undertakes impact assessments. It appears to achieve these tasks well and we have seen evidence that the Commission takes the data it gathers into account in its work (although see our responses to Questions 2 and 9 on impact assessments).

But none of this is true of the European Parliament. Many MEPs are from countries with small and relatively undifferentiated retail financial markets run almost entirely by universal banks that control the provision of almost all financial products and services. The European Parliament Committee structure helps by selecting the more financially literate MEPs for the Economic and Monetary Affairs (ECON) Committee which has the key Parliamentary control over financial market legislation, but it is unclear whether all of the MEP offices are appropriately staffed from a financial market perspective. Even if they are, the European Parliament rarely undertakes evidence gathering in the way that the Commission does, nor does it as a corporate body seek impartial external advice – and it certainly does not do impact assessments or cost-benefit analyses. There is, however, plenty of evidence of individual rapporteurs seeking advice that suits their particular political persuasion. This results in Parliamentary responses to Commission legislative proposals that are often lacking in focus, whimsical in reflecting the pet ideas of the rapporteur (or other provider of amendments) that are often only partially relevant, and broad catchalls embracing numbers of issues beyond those in the initial focus of the proposals. This creates excess volume, lack of relevant detail, and poor quality legislation that is often misguided or off-target. Good examples include the European Parliament version of the PRIPs legislation, the ill-thought through bonus cap in CRD IV and the attempted bonus cap in UCITS V. One notable exception was the example of the Rapporteur for the MiFID/R proposals who developed his understanding of the impact of proposed legislation via a questionnaire for stakeholders, a practice we would like to see more widely used.

A corollary of this is that the MiFID/R Rapporteur is from a member state, and a Parliamentary grouping from within that member state, that is very well briefed on issues from its domestic "mother party" counterparty. Its positions and approaches will not always concur with its Government's, and there is a sense in which the domestic/EU link makes it harder to affect the views of some of its MEPs when European rather than national issues are at stake.

On the other hand, the MEPs are selected to represent constituencies in their home country and the EU "view" should come from a resolution of the differences between different national groupings in Brussels. So it is difficult to mount a criticism from this point of view. The position is in any case trumped by the fact that good coordination tends to mean that then views of this group are well formulated and reflect their domestic opinion. It also means that Parliamentarians in the home state are well briefed on matters European in return. For the UK the situation seems to us to be different. There appears to us to be limited correspondence between representatives in Brussels and their home party colleagues. Views tend to be less reflective of domestic goals and policies. In particular, Westminster MPs seldom display a clear connection with their colleagues in the European Parliament and do not demonstrate knowledge of what is going on there.

We contend that the UK would be much more successful in the EU legislative processes if the links were closer and briefings and policy lines tighter; this would also no doubt raise the quality of debate and legislation on financial services in the Brussels machinery. As for the UK, the quality of domestic debate on EU issues would likely be much higher if inter-Parliamentary party information flows and connections were a good deal tighter and less uncoordinated. It might also help MPs to understand more clearly the negative effects on people's feelings about the EU to have the constant flow from Brussels of instructions on what to do from people who often know little about financial markets and how they operate.

As a result of the conflicting forces described above, the financial services sector has to put in a great deal of effort to put matters right. Indeed, the amount of this effort is a measure of the degree of damage done by inadequate and inefficient law and rule making at EU level, and is totally out of line with growth agendas.

The Council has similar difficulties in securing consensus amongst Member States. However, the ability of governments to command skills and expertise in staff and advice and information from market participants to provide coherent views under the Presidency of the day helps the Council in generally delivering reasoned and well-thought through texts.

At the level of the ESAs, there appears to be an on-going need for more staff but the use of Committees helps by drawing upon the expertise of the national regulators. This brings local market understanding to the creation of Level 2 proposals and texts. Their Guidance and RTSs are generally reasonably well drafted but their position in the EU structure creates ambiguities in understanding the legal force behind their documents. As noted earlier in our response to this question, there is also a problem with national law and the creation of rules: if local supervisors say they must follow the approaches set out in ESA papers without interpretation then it may not be clear to firms what the supervisors want them to do, especially if the language of an ESA requirement governs supervisor behaviour and does not prescribe expectations to be placed on the supervised entity. Firms simply will not understand precisely what is needed and the result will be unnecessary friction between firm and supervisor because of the ESA intervention (see also our response to Question 9).

Fourth, as elaborated elsewhere in this response, problems arise because of failure to differentiate between retail and wholesale markets at EU level. The definitions are a problem here as is the failure to take account of different market structures. Laws and regulations designed to target large cross-border banks invariably refer not only to credit institutions but also to investment firms. These may include large investment firms which are themselves systemic, but it will also include very small retail only investment firms that are not and should not be subject to the same legislation and rules. Although attempts are made to use proportionality or domestic definitions to exempt such firms from some of the main problem areas, as with CRD IV for example, there are invariably rules that get through with smaller firms getting caught unnecessarily and sometimes damagingly.

Fifth, in the financial services sector other countries are behind the UK in many ways in their market and regulatory development. The UK is thus often dragged into rule making work in areas we do not need to visit. It also means that from the UK perspective there is too much EU legislation for financial services because we already have a great deal of it in our rules. The constant flow of excess new legislation can make it difficult to implement existing material in the pipeline before more legislation introduces more change. It also makes inconsistencies and legislative incoherence more likely, and it adds greatly to the costs borne by firms and above all the consumer.

The UK's role in mitigating these tendencies would be strengthened if the FCA had a clear strategic plan for EU work over (say) the next year. It could present this to colleagues in other EU regulatory authorities, at ESMA, and in the European Commission to influence their work programmes and priorities, while using it internally to bring cohesion to its own work on EU issues. This would help to prevent cross-cutting or chronologically disordered output from the FCA to domestic firms, and help control a more logical flow that would be less costly to implement, and require less lobbying from market representatives to put the work into a more manageable sequence.

Sixth, failure to implement consistently across the EU causes difficulties. It is almost always the case at EU level that more legislation is introduced to put right problems arising because of the failure to implement properly some previous piece of legislation. This leads to more overlaps, incoherence and excess when it would be far better if the EU had a proper mechanism for ensuring implementation across the continent in a consistent manner. The ESAs are supposed to make this happen but there is little evidence of success so far.

Seventh, there is a marked tendency to find that Level 1 texts get too detailed in EU financial services legislation leaving no space for the ESAs to do their job at Level 2. This is unhelpful and should be minimised.

Finally, the minimum and maximum harmonisation concepts have their place but create a tendency in the UK to develop domestic super-equivalence. We find this anti-competitive with no investor and market benefit and would like to see the habit terminated.

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

This is less of a problem now that MiFID/R has adopted the Presidency compromise to establish what is in effect the status quo ante for retail firms. It should be noted that the UK has historically operated an open economy based on open market access, exports, and international trading links. We would be better served by practising what we preach in this regard and arguing to bring most and not just a few of our continental colleagues with us. The EU should not try to adopt or second-guess the rules of other nations and then seek to beat them at what we think is their own game. This way lies defeat and failure. We need to play by our own rules: for the UK, this has to be open markets and global trading regardless of how this sits with our EU colleagues, some of whom may have more protectionist approaches. Otherwise our industry as well as economic growth – and with them the employment and tax take – will be gone.

The third country access restrictions in the AIFMD and original MiFID texts are not only bad for the UK but also for the EU as a whole. They affect not only the USA and other trading partners but also the UK Crown Dependencies with which we have strong historical ties as well as substantial business interests.

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

As we have explained in our earlier response to Question 2, retail financial services are mainly national in offering rather than EU-wide in the sense that there is currently little retail use of financial services offered cross-border due to differences in language, culture and tax law. It should however be recalled (as stated in our Question 2 answer) that use of the regulated markets for investment on a cross-border basis in the products quoted on them by retail firms for their clients does take place and should continue.

However the absence of retail services or packaged products (except UCITS) being much purchased cross-border makes it difficult to implement common approaches across the EU for retail business at anything other than the highest level of principle. There is also a wide choice of financial services firms offering services to retail consumers across the EU in terms of size, business model and structure.

In the UK, within the wealth management sector alone, firms range from the wealth management arm of investment banks through to small retail brokers employing less than five staff, offering a variety of bespoke services from full discretionary management through to execution-only dealing. Many such firms are separate from financial product manufacturers and survey the wider market for appropriate investments. This relates to definitions of independent and restricted in the RDR, which has included pensions and life insurance among products in which firms must have expertise if they are to be afforded independent status. But MiFID II says this can come about with a wide knowledge of equities and bonds and excludes pensions and life insurance. It is not at the time of writing clear which of these will prevail or how the conflict will be resolved. Meanwhile IFAs are exempt from the MiFID so do not have the equity and bond requirement at all. The situation is very confusing, especially to the consumer in whose interests the various pieces of legislation and regulation were passed.

The UK structures are very different from what might be available under the *bancassurance* model which is prevalent in continental Europe. When developing regulation for retail financial services, European institutions need to recognise these differences and not impose across-the-board solutions that do not fit the business model of a significant part of the retail financial community.

This suggests that Directives, rather than Regulations, are more suitable vehicles for implementing retail markets legislation. It is to be welcomed that the EU comprises such an interesting and historic diversity of social, cultural and linguistic regions, but vital that European institutions respect such differences – differences which must also be reflected in how EU financial services legislation is framed: attempting to put in place identical rules and laws, rather than common experiences of the retail service offering, may well cause consumer detriment rather than prevent it – especially in countries like the UK where strong consumer protection rules are already in place and adhered to by the vast majority of firms operating in this sector. Unified European-wide “one size fits all” legislation has been and could continue to be disastrous in this context where the retail consumer ends up paying for legislative and regulatory mistakes.

There is also a problem with passporting that is not addressed by EU legislation and in our view should be. Firms from other member states can for example passport into the UK and address UK retail clients directly or via a UK branch. They will not be subject to RDR disciplines, which under MiFID means that foreign firms defining themselves as restricted will be able to offer advice without fees because they can still charge commission. This will attract clients who have to pay UK firms but do not want to. But in doing this the UK client will not be told that the product or firm originating in another EU member state will not be covered by the UK compensation scheme and that the firm may be subject to a lower level of regulation than in the UK. The result will be that the client will not get redress when a bankruptcy or product failure arises, or when mis-selling is demonstrated. These and other anomalies need to be addressed at the EU level if the single European retail financial market, in a rare moment where it does have some recognisable form, is not to be dangerous to the consumer.

Even when the European Commission uses Directives as the vehicle for implementing legislation for retail financial services, proposals need to be more targeted in scope and European institutions need to refrain from using them as a 'catch-all' for any idea they wish to see make it into law. This would allow proposals to be more rapidly agreed and implemented across Member States and prevent proposals for legislation meant for one market sector from being automatically applied to others.

In the context of consumer protection, European institutions should again consider carefully how far they can advise in this area given the extent to which each local market implements different practices. It is national Competent Authorities, such as the FCA in the UK, that are better placed than European equivalents to propose and implement consumer protection in a way that takes into account local social and cultural factors, thereby increasing the likelihood that consumers will take heed of their work: European-wide initiatives seem to add little, if anything, to this. As a result, the clients of WMA member firms typically do not look to Europe for guidance on consumer protection issues and their role seems limited. Attempting to harmonise consumer protection rules across different member states too prescriptively and too quickly could well be unhelpful and potentially cause major disruption, adversely affecting the very consumers whom we are trying to protect.

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?*

In the context of retail financial services, we question the degree to which regulation and supervision at the EU level is meaningful given the national focus of the retail markets. As argued elsewhere in this paper, we believe it should be rebalanced towards the national level, using EU legislation only on points of principle to form a framework guide within which local legislation and regulation should be formed. Supervision at EU level distances the firms being supervised from their supervisor, which only serves to magnify the disconnections between regulated entities and their supervisors, and reduce accountability and transparency. Instead, supervisors should remain close to the markets they supervise – and the end consumers of financial services whom they ultimately serve.

In practical terms, for example, we do not consider that the ESAs and their stakeholder groups are sufficiently accessible for stakeholders not directly represented on these groups and there is no mechanism for smaller firms, such as the members of WMA, to offer their expertise. It is difficult for them to visit or even to know whom to contact in an ESA about an issue. ESMA's SMSG is seen as being very remote from, and not representative of, the activities of WMA member firms, whose main activity is to act as agent on behalf of private clients. Small wealth management firms are also unlikely to be represented on the group due to the costs associated with membership. In addition, there are problems of scale: in the case of the UK, small financial services firms would find it difficult to access the CEO of the FCA, who would represent their interests at ESMA, but who in reality represents over 27,000 such firms and so is not in a position to take up the cause of a few.

Relationships between the ESAs and national Competent Authorities may also increase confusion, especially for smaller firms who still generally look to national Competent Authorities for information. We addressed some aspects of this problem in our response to Question 4. Not all Competent Authorities publish ESA documentation on their websites and, even when it is published there, it is not always clear whether – and what – action is required of individual firms as the documentation is almost inevitably directed at the Competent Authority rather than the regulated entity (currently the Credit Rating Agencies are the only exception). Competent Authorities are not in a position to interpret such documentation further for firms because they are concerned about EU legal requirements to act in the manner set out by the ESAs, with their binding authority to compel national supervisors to comply.

This adds to the confusion, for example when firms want to know if they should comply with existing Competent Authority rules or new ESA Regulatory Technical Standards. If firms should comply with the latter, it is not clear how firms should comply, because the language is very different from what they are accustomed to and the Competent Authority refuses to say because it does not wish to interpret.

There is also an issue of abrogation of national legal requirements for rule making, including the ability of firms to challenge and seek appeal. This mechanism is lost in ESA Regulation, which is simply imposed after consultation with no further explanation. In the UK this leads to a sense of excess 'dirigisme' being imposed on a country where the culture and history do not support this approach. This leads to very unhealthy regulatory, and indeed political, situations.

Overall, the ESAs appear to have made little change to the UK retail financial services industry and they have had almost no contact at all with this sector. We note that the UK national supervisory culture appears more intrusive and effective than that in the rest of Europe; we believe that the issue to be addressed is whether the ESAs will compel other countries to raise their standards of regulatory thinking and supervisory practice to those of the UK.

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?*

We do not believe that the UK has an appropriate level of influence on EU legislation for financial services especially in light of the size of its financial markets in comparison to other European Member States. One particular example of the lack of influence the UK has over legislation that impacts it more than other countries is the Alternative Investment Fund Managers Directive (AIFMD)[5]. The UK manages 85% of European hedge fund assets[6] and yet was unable to significantly influence the Directive's initial form, and only after intensive, expensive, and lengthy lobbying were we able to achieve

5 Directive 2011/61/EU on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010.

6 TheCityUK (2013) '*UK and the EU: a mutually beneficial relationship*', [online], http://www.thecityuk.com/research/our-work/reports-list/uk-and-the-eu-a-mutually-beneficial-relationship/ (Accessed 16 January 2014).

something reasonably acceptable to the hedge fund industry in final form that would not put it out of business in the UK (as has happened elsewhere in the EU). In such cases, the purpose of the influence of other Member States is questionable.

Generally, the way that financial services legislation is agreed within Europe does not take into account the scale, level of sophistication, development or structure of each country's financial services sector. The UK's financial services industry (and related professional services) is the largest in Europe and both the UK, and Europe more widely, benefits from the existence of such an accumulation and critical mass of services. But the way agreements in Council are reached instead reflect the size of that Member State's population. This makes it very difficult for the UK to block proposals on the grounds of its impact on their markets, especially where the UK has no right to veto proposals to reform financial services.

In the absence of a veto the just and fair nature of the current and planned QMV systems is open to dispute. It would in our view in the financial services sector be more equitable if QMV were related to the size of the financial markets of member states rather than their population. This would give the UK a more appropriate position from which to influence the Council on financial services matters.

Alternatively, the UK should be more willing to make greater use of the Luxembourg compromise forced by the French over 30 years ago when key national interests were at stake for them. It seems to us that the value of financial services to the UK economy places it in the category of a key national interest and it should on occasion be defended with the same Luxembourg compromise zeal. We note that the House of Lords Scrutiny Committee has the power to make recommendations aimed at affecting whether and how EU legislation is implemented in the UK, which is useful. European institutions can unfortunately ignore what it says at will and it has no enforcement powers. But a guardian of the UK's national interests of this kind with real teeth and the ability to stop legislation being implemented if it is against our interests would in the view of some be highly desirable.

On a day-to-day basis, with regard to the European Parliament, we would like to see better engagement between the financial services industry and Rapporteurs for EU financial services legislative proposals (cf our proposal in our Question 4 response for better FCA strategic planning of EU business): we are aware that UK trade associations have sometimes found it difficult to get Rapporteurs and shadow Rapporteurs to meet with them and have, in some cases, had requests for meetings repeatedly turned down. Further, Rapporteurs do not always have financial services expertise (cf our response to Question 4 above), so that the wider implications of proposals may not be fully understood. More generally, there seems to be little understanding of market operations in different countries, especially the range of market structures used in the UK. These factors result in proposals that seem to be heavily influenced by the way in which markets operate in the Member State of the Rapporteur, and Rapporteurs subsequently being unresponsive to views from organisations in other Member States, which means that the experience of representative bodies such as the WMA is even more important. Such unresponsiveness reduces our influence over legislative proposals, as well as being unbecoming of a publicly elected body.

We believe that the European Parliament should consider how it can become more accessible and accountable to the full range of stakeholders across all Member States to aid stakeholders' active participation in relation to financial services legislation. It would also be helpful to have more precisely targeted legislation that takes into account the nature of the UK markets in order to compensate for some of the above points. See too our response to Question 1.

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 have provided a great deal of detail on the issues we face in dealing with the various institutions involved in the EU policy-making process in our response to Question 4 and we do not intend to repeat them here.

We would note in addition, however, that there seems to be a lack of Commission accountability which can cause problems, for example, in deciding whether a proposal should take the form of a Directive or a Regulation. There appears to be little transparency around how this decision is made, and it is certainly a point that we have never seen consulted upon. We would like to see this change.

The Commission has in recent years generally improved its consultation processes and the transparency with which it conducts them. Our experience is also that, where the weight of argument is opposed to particular approaches or analyses, the Commission will in some cases respond favourably and make changes. So there is a sense of genuine consultation. But the effectiveness of consultation remains contingent on other factors as well, including political direction regarding achieving a particular outcome and the degree to which different services within the Commission support or oppose a particular consultation answer. All this leaves the retail financial services sector sceptical about the origins and market or investor value of some of the Commission reactions to consultation outcomes.

As regards impact assessments, we have commented on these in our Question 4 answer. While welcoming them we should also note that we are unclear how much influence they have, while it is quite obvious from the FTT case that they can be comprehensively ignored if politics become involved.

There is also little transparency surrounding the trilogue process which is not always helpful in understanding the context in which the final form legislation is decided. We believe that more openness surrounding this would be helpful. It is these sorts of deficiencies that make us and our firms' clients question whether due process really is properly respected.

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?*

No comment.

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?*

It is clear that banking union will bring with it increased risks of the UK being block-voted against in certain areas of financial services legislation (this may overspill beyond banking into the territory of the investment firms). We therefore need to be very aware of the boundaries of banking union, especially in light of the different market structures in the UK and continental Europe (the *bancassurance* model: see our response to Question 1).

However, this could also be an opportune time for the UK to re-brand itself as the key "offshore area" within the EU. In particular, the traditional role of the UK as the financial entrepôt between continental Europe and the rest of the world should be re-emphasised and built up even more.

The UK should also start to brand itself as the centre of the international European Wealth Management Industry. This is growing fast and many firms developing wealth management arms, or already being in wealth management, are moving to London or opening entities here to benefit from London’s international credentials. With the only regulator in Europe to have a dedicated wealth management unit, and all the other known international advantages of London, we should work to capitalise on this movement as much as possible.

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

We would welcome some indication of how the UK government intends to manage any dilution of the UK’s negotiating power arising after the European parliamentary elections in May. There is a real risk that a number of Member States elect a significant number of MEPs that are opposed to the EU and its institutions, who may then pursue a policy of non-cooperation which could severely curtail the ability of the wider European Parliament to influence the future direction of EU policy. But it will be no less important than it is now for our sector to have its voice heard where policy is being discussed and debated. Even in the UK, MPs (and MEPs) run the risk of the 4m UK consumers that are clients of our firms being influenced negatively and in general terms that the EU is ‘bad’ and is adding to the costs of building up savings and other long-term investments.

No matter which party wins the most seats at the coming election, the UK needs to be at the negotiating tables whenever policy is being discussed that will impact the UK's financial sector. This is a point we will be making to all of the major political parties as we approach the election, and we also wish to record it here.

Wealth Management Association
17 January 2014