



The Gilded Cage

- gold plating EU legislation
into UK law and regulation

**the Association of
Private Client Investment Managers
and Stockbrokers**

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Foreword

The Financial Services Action Plan (FSAP) is the European Commission's programme of directives and rule changes which aims to bring about a harmonised market in financial services by 2006. The last measures are currently being agreed by the EU institutions and detailed rule-making is now beginning in earnest at the Committee of European Securities Regulators (CESR).

Now is the time to consider how these rule changes are to be implemented across the EU's member states. With the extensive set of new requirements that will flow from this Plan, it is essential that the UK does not find itself at a competitive disadvantage to other EU countries due to additional requirements placed mostly - or only - on UK-quartered firms.

An earlier version of this paper was prepared for the UK's Treasury Select Committee to highlight some of the key reasons why the UK appears to "gold plate" European legislation.

A handwritten signature in black ink, appearing to read 'A Knight', written in a cursive style.

Angela Knight

Chief Executive, APCIMS

Introduction

The European regulatory programme is extensive and, in the form of the Financial Services Action Plan, is about to result in a further 40-plus significant pieces of legislation and changes to be implemented across the next three years. A non-exhaustive list of the major changes is included in the Appendix.

The industry is concerned at the quantity of these changes, the speed of change, the costs and consequences to the consumer and in particular the way in which the UK implements the many EU-derived requirements on this list.

Does the UK gold plate?

The expression “gold plating” is used by the industry to describe four scenarios:

1. when the UK implements an EU requirement the same way as other European countries but puts in additional rules;
2. when the UK implements an EU requirement differently to other European countries with the result that there are more extensive requirements placed on UK firms;
3. when the UK implements an EU requirement which other European countries have ignored (or which they have transposed into their laws but not implemented); or
4. when all European countries have implemented a directive but the UK enforces it with a much more extensive penalty regime.

What are examples of gold plating?

There are many examples and below we list a few that are particularly relevant.

The Investment Services Directive and capital adequacy

When the current Investment Services Directive was put in place, the UK included as an “ISD” firm most of the financial services industry, exempting only the IFA. This resulted both in rule changes and in additional capital requirements from the accompanying Capital Adequacy Directive (or CAD). Germany, on the other hand, exempted its entire portfolio management business from the ISD (and so from CAD!). The ISD was put in place to allow “passporting” of financial services from one country to another. Although this has worked for the collective investment industry (via the UCITS rules), it has not worked in practice for stockbroking or portfolio management services. In fact one firm recently announced that it was easier to take on a client who lived in Beijing than one who lived in Paris. By implementing the current ISD in the way that it did, the UK added costs to firms for whom there was little if any cross-border business benefit.

Calculating capital adequacy

There is also the question of how this capital is calculated. For non-banks their CAD requirement is calculated by a method known as the expenditure based requirement (EBR). This is interpreted as requiring a firm to hold three months’ expenditure as readily available capital. However, what counts as expenditure varies from country to country and clearly the more that is included in a firm’s expenditure, the higher its regulatory capital requirement. The UK elected to put more into expenditure than any other European country. This therefore puts much of the UK investment business at an effective commercial disadvantage not just to those countries which exempted this type of business from the ISD, but even to those which included it!

Cooling-off periods for distance marketing

The Distance Marketing Directive has just been agreed and is currently out for consultation in the UK. The DMD gives cooling-off rights to customers who have signed for a service and includes not only cross-border services but also anything that does not take place face-to-face. There are important exemptions for investments such as equities, where prices can fluctuate very significantly from day to day and so cooling-off periods cannot be given. The FSA consultation paper on implementation changes for financial firms such as stockbrokers and private client investment managers runs to over 100 pages. In addition the FSA interpretation of what a client is required to be told over the telephone is so extensive that one trade association has taken expensive detailed advice in order to prove this interpretation is wrong. We can find no other European country proposing to make any changes to their financial services industry requirements – elsewhere it is all deemed to be exempted because of the fluctuating nature of investments.

Business changes for IFAs

The Insurance Mediation Directive is again a recently agreed directive and the FSA has just closed the consultation on its implementation. The Directive requires certain information to be given to a consumer before conclusion of the contract. There are various ways in which this expression needs to be interpreted because of the different types of business that is undertaken. However the interpretation that is being made in the UK will require significant changes to IFA business engineering without any identifiable consumer benefit.

How does this gold plating come about?

Gold plating is not only limited to the way the UK implements a directive, but also to how it enforces it. For example, the UK will put a directive into a mixture of UK law and FSA rules. As part of the process the UK will examine the directive and, where the directive text is unclear, it will make assumptions of what the intention is and will adjust the law and rules accordingly. Many (if not most) European countries transpose the directive into their own law, including those areas which lack clarity, with the consequence that there are fewer requirements placed upon their industries. A crude approximation is to say that everything that is not absolutely clear is put into the “too difficult box” by others but not by the UK.

There are some occasions when gold plating is wanted by the industry and these should be agreed as part of the consultative process. Some specific examples are:

- i) Once a directive has been passed into a mixture of UK laws and UK rules, the FSA is then given the responsibility for supervision and enforcement. The FSA has at its disposal a range of sanctions where firms have not implemented rules correctly which include significant fines and adverse publicity. We know of no other European country which takes either of these two actions except in very extreme circumstances.
- ii) The UK implements directives on time and, indeed, sometimes early. Implementing early does not mean that the firms in that country can take advantage of the freedoms that the directive contains. In fact it can be necessary to wait until all EU countries have implemented the directive, even though the deadline may have passed. Speed can cause a greater cost problem than the changes themselves - it requires firms to make changes in advance of either their normal systems updating or changes that are out of step with other FSA-generated requirements. Implementation timing should therefore be part of the consultation with the industry.
- iii) The UK regulates some activities that other countries do not regulate. An obvious example of this is requiring individuals who advise the private

investor to be qualified. Several EU countries do not require formal qualifications for such advice. While we support strongly the regulation of financial advice, this is an example of how differences arise.

- iv) Execution only (or no-advice) trading is a popular activity in the UK, accounting for some eight million share trades last year, as well as many more of collective investments such as unit trusts. These activities are well defined in the UK but are differently viewed in most other European countries, with the result that often more can be sold on an execution only basis. Indeed in some cases there is no ongoing responsibility on an adviser to ensure the suitability of the investment for the customer.
- v) A Commission Directive some four or so years ago required all EU countries to set up a financial ombudsman service. Although there are some 50-plus ombudsmen in the 15 EU countries, we understand that the only comprehensive service is in the UK. This is the only one solely paid for by the industry, hence this is the only country in which a firm has to pay the cost of a customer's complaint even when the customer is found to be in the wrong. It is also the only one in which firms have a requirement to inform their customers how to complain.

Whilst we agree with the proper implementation and enforcement of EU agreed proposals, with the regulation of advice and with a properly operating Ombudsman, evidently the cumulative effect of the way in which we have approached each of these issues results in a climate of constant change and more cost to a UK firm than to its counterparts and competitors elsewhere in the EU.

What can be done?

There are a number of areas where it is possible to improve the process. Some of these are:

1. The UK should seek to implement the intention behind the directive.
2. The UK should seek to be pragmatic in its implementation rather than perfect and as far as possible should allow existing sensible commercial and regulatory practices to continue where they meet the directive's intention. For example, we are told that the Nordic countries consider that their legislation/requirements match the intention of the Market Abuse Directive and so do not propose changes. The UK also matches the intention of the Directive, but we are making a great many changes.
3. The UK should proceed at the same pace as the rest of the EU and should not necessarily seek to make changes early unless it is in its interest to do so.
4. The UK should conduct not only cost benefit analysis on each directive (and the rules that flow from it), but also a cumulative costing. It needs to be recognised that whilst each measure may be viable in its own right, the problem for the industry is that all changes apply to many firms and therefore the costs of the changes are substantial. Undertaking such analyses directs the attention of policy makers to the issue of cost and also enables decisions to be taken about the best way of undertaking the required change.
5. The FSA and the Treasury should review the UK implementation and enforcement of directives in light of the experience both of the UK and of other EU countries. Such a process would clarify how the UK is acting compared with other EU countries and would provide an opportunity to make changes, should this be necessary. Any such changes should only take place in consultation with, and with the agreement of, the industry.

6. At all stages of transposition and implementation of new EU requirements, the UK must avoid the temptation to make additions that are not required. They should also determine what other European countries are doing at all stages, using the CESR group as a source of information.
7. An increasing number of firms consider that regulatory changes should normally only take place twice a year at, say, 1st January and 1st July. Such a requirement could reduce the cost of constant change to firms and enable them to plan for the changes. It could also concentrate the minds of policymakers on what is really required.
8. Whilst we agreed that fines should be substantial where a firm's action or inaction has resulted in a loss to the customer, fines should be lower where there has been no loss.
9. With the substantial increase in rules and regulations flowing from the Financial Services Action Plan, our view is that the totality of regulation should be considered. By this we mean that where new rules are being made in a particular area, existing rules should be reviewed with a view to minimising the burden by removing as many as possible.

APPENDIX: List of selected major legislative and rules changes to be imposed over next three years

Directive	Initiator	Implementation Date	EU				UK			
			Consultation	First Reading	Second Reading	Adopted	Department Consultation	Transposed into UK law	FSA consultation	Transposed into FSA Rule Book
Private & Electronic Communications Regs 2003	EU	11-Dec-03		✓	✓	✓				
Financial Collateral arrangements	EU	27-Dec-03		✓	✓	✓	✓			
Amendments to the 4 th & 7 th Company Law Directives to allow the Fair Value Accounting Directive	EU	01-Jan-04		✓	✓	✓				
UCITS	EU	01-Feb-04		✓	✓	✓				
Winding Up & Liquidation of Banks	EU	05-May-04		✓	✓	✓				
Directive 2002/83/EC Life Assurance	EU	19-June-04		✓	✓	✓				
Financial Conglomerates	EU	11-Aug-04	✓	✓	✓	✓	✓		✓	
Implementing UCITS Simplified Prospectus	EU	01-Sept-04							✓	
Consumer Credit Act advertising	UK & EU	01-Oct-04								
Consumer Credit Act e-commerce	UK & EU	01-Oct-04	✓	✓	✓	✓				
Investment Services Directive (now Financial Instruments and Markets Directive)	UK & EU	30-Apr-04	✓	✓	✓	✓				
Consumer Credit Act – Early Settlement	UK & EU	01-Oct-04								
Consumer Credit Act – Form & Content of Agreements	UK & EU	01-Oct-04								
European Company Statute	EU	08-Oct-04		✓	✓	✓	✓			
Distance Marketing Directive	EU	09-Oct-04	✓	✓	✓	✓	✓		✓	✓

Directive	Initiator	Implementation Date	EU				UK			
			Consultation	First Reading	Second Reading	Adopted	Department Consultation	Transposed into UK law	FSA consultation	Transposed into FSA Rule Book
Market Abuse Directive	EU	12-Oct-04		✓	✓	✓	✓			
Regulation of Mortgage Business	UK	31-Oct-04					✓	✓	✓	
FSA regulation of long-term care insurance	UK	31-Oct-04					✓		✓	
FS19 Regulation of simplified investments		31-Oct-04								
Transparency Obligations Directive	EU	31-Dec-04	✓			✓				
Directive to modernise the accounting provisions of the 4 th & 7 th Company Law Directives	EU	01-Jan-05		✓	✓	✓				
Takeover Bids (13 th company law directive)	EU	01-Jan-05		✓	✓	✓				
Conduct of Business Rules for non investment insurance contracts	UK	01-Jan-05								
FSA regulation of general insurance	UK	14-Jan-05					✓		✓	
Insurance Mediation Directive 2002/92/EC	EU	23-Mar-03		✓	✓	✓	✓		✓	
Simplification of pension tax (DWP/1R)	UK	01-Apr-05		✓	✓	✓				
3 rd Money Laundering Directive	EU	tba								
Action Plan on Company Law & Corporate Governance	EU	tba	✓	awaited						
Clearing & Settlement Communication	EU	tba	✓							
Company Law Auditor & Directory liability	UK	n/a					✓			
Consumer Credit Directive	EU	tba	✓							
DP20 issues for with profits business	UK	tba								

Directive	Initiator	Implementation Date	EU				UK			
			Consultation	First Reading	Second Reading	Adopted	Department Consultation	Transposed into UK law	FSA consultation	Transposed into FSA Rule Book
Draft revised employment tribunal regulations & rules or procedure	UK	n/a					✓			
EC Regulation Consumer Protection Co-operation	EU	tba								
Insurance solvency	EU	tba								
Mortgage credit – European market for home loans	EU	tba								
Mortgage credit – integrated market for mortgage credit	EU	tba								
Payments in the internal Market	EU	tba								
Reinsurance Directive	EU	tba	✓							
Risk-Based Capital Directive	EU	tba	✓				✓			
Unfair Commercial Practices Directive	EU	tba	✓	✓						
Parent Subsidiary Directive – common system of taxation	EU	tba								
Corporate Social Responsibility	EU	tba								
Prospectuses Directive	EU	1-Jul-05	✓	✓	✓	✓			✓	
EU SME Code	EU	tba								