

EFAMA response to the Commission's consultation on the future of financial services supervision in the EU

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Introduction

EFAMA is grateful to the European Commission for the opportunity to contribute to the consultation on the future of financial services supervision in the EU. We represent 24 national member associations and 44 corporate members across Europe, managing about EUR 14 trillion, of which EUR 6.1 trillion are managed by around 53,000 investment funds (at end 2008)¹. As such we represent an important part of the **buy-side** of financial markets and our members' business activities are defined by their **cross-border nature**, as opposed to the often domestic character of a large proportion of activities carried out by banks and insurance undertakings. EFAMA members, therefore, have **a strong interest in a harmonised European supervisory framework with powerful European authorities cooperating closely with national supervisors**. The inherent logic of the internal market calls for Community legislation to be accompanied by harmonised EU-supervisory standards, thereby reducing the compliance costs linked with 27 supervisory practices.

EFAMA members **welcome the proposals made by the de Larosière Group** on the future supervisory framework. However, we are concerned that by simply following the Group's recommendations, the Commission might approach the modernisation from a purely banking and insurance perspective, **ignoring the securities sector in general and the asset management industry in particular**. Experience from recent legislative initiatives seems to indicate a dominant role of the sell-side interests in EU legislation, neglecting the other part of the market, i.e. the buy-side.

Supervision should aim to encourage the smooth functioning of markets and the development of a competitive industry. However, even competent supervision cannot compensate for failures in financial regulatory policy. Therefore, we deem it necessary not only to comment on the proposals for the future supervisory architecture, but also on the regulatory framework.

¹ For more information, please visit www.efama.org.

Regulation

Stable financial markets and trust among all market participants are a necessary prerequisite for an effective asset management industry. As the Commission correctly states in Volume 2 of its Communication, “the UCITS regulatory framework has worked well during the crisis in shielding investors from exposure to risks other than market risk”, and we believe that the **fund and asset management sector as a whole has proved fairly robust** over the past months. Nevertheless, EFAMA members acknowledge that some weaknesses have been identified especially with regard to certain money market funds and that a very limited number of UCITS funds have suffered from the alleged Madoff fraud in the US. In reaction to this, EFAMA has created two working groups to analyse the current situation and, where necessary, propose improvements. Any regulatory reaction to these events must only be given after a careful and thorough analysis, and we stand ready to work in close cooperation on these issues with the Commission.

This said, we strongly believe that any **regulatory effort must above all concentrate on improved banking regulation** in order to restore confidence in financial markets. In this context, EFAMA members take note of the Commission’s intention to further modify the Capital Requirements Directive. In spite of the urgency to act, we call on the Commission to ensure that changes to the regulatory capital regime for banks do not unintentionally or disproportionately impact other sectors of the industry also subject to CRD, such as asset managers. The business model of banks differs fundamentally from that of asset managers where clients’ assets are kept separate from the assets of the managers. Therefore, a one-size-fits-all approach should not be applied.

In conclusion, EFAMA members are convinced that regulatory reform must be targeted, measured and considered, and regulatory arbitrage must be avoided. Reform should focus on those sub-sectors where regulatory deficiencies have been identified. There must be **no automatic read-across of regulation to the asset management sector** which was not at the origin of the crisis and where existing regulation proved adequate.

Supervision at EU-level

Macro-prudential oversight

EFAMA members recognise the need for adequate macro-prudential supervision and effective early warning mechanisms. Therefore, we can see some benefits in the creation of a European Systemic Risk Council and we share the Group’s view that “to be effective macro-prudential supervision must encompass all sectors of finance and not be confined to banks” (p.38). As an industry, **we are willing to provide the data necessary to prevent the accumulation of risks subject to the condition that appropriate guarantees for confidentiality are given** and that it is **simply possible for our industry to provide the data requested**.

In addition, we want to emphasise that a **duplication of reporting requirements**, i.e. that the same information has to be provided to various bodies in various formats, **must be avoided**, and that existing information sources should be exploited fully before imposing new requirements. The efficiency and success of the ESRC will depend on the information flow between the ESRC and the micro-prudential, i.e. the future European Authorities and national supervisors. Asset managers should not be required to report the same information to various authorities, instead authorities should agree to exchange this information amongst them. This implies that reporting requirements should be streamlined both in terms of format and content whilst being proportionate and tailored to the specific characteristics of the entities required to report. Indeed, the reporting requirements should not place an unreasonable burden upon market participants in terms of costs and efforts, and an obligation to report each and every transaction should be avoided.

Finally, we believe that **proper and permanent representation of the asset management industry must be ensured** in a future “European Systemic Risk Council”. We welcome Recommendation 16 stating that “high-level alternates to the central bank Governors should take part in the discussions, in particular when insurance or securities markets issues are discussed”. However, EFAMA members are concerned that the permission of the high-level alternates to take part only in specific discussions (and not on an ongoing basis) will not sufficiently take into account the importance and needs of the asset management industry as the buy-side in financial markets. We see the risk that macro-prudential supervision will be exercised from a purely banking perspective, which should be avoided.

Micro-prudential oversight

Establishing a European System of Financial Supervision

The 3L3 Committees have reached their limits, not only in terms of resources, but also legal powers. Therefore, EFAMA members **strongly support the strengthening of the 3L3 Committees and transforming them into European Authorities with real powers whilst leaving day-to-day supervision to national supervisors**, thus making full use of their local knowledge. This will help to reduce significantly the huge compliance costs faced by EFAMA members who operate on a cross-border basis in the securities markets of all 27 EU Member States.

In particular, we welcome the proposal that the future authorities should be able to adopt **binding technical level 3 interpretation and supervisory standards**. This will help to prevent Member States and national regulators from gold-plating of EU rules. In this context, EFAMA members stress the **need for timely interpretation of EU rules**, meaning that for each project, deadlines should be fixed by which binding technical level 3 interpretation and supervisory standards have to be issued in order to ensure coherent interpretation across Europe, legal certainty and a smooth functioning of the internal market.

Finally, we support Recommendation 21 that **licensing and supervision of specific EU-wide institutions** such as credit rating agencies shall be **within the key competences of the future Authorities**. Such a step is justified because credit rating agencies are few, operate on a pan-European (and even global) scale and need common oversight. Moreover, a bankruptcy of a credit rating agency would not be detrimental to national taxpayers since they do not deal with financial assets directly. There might be some merit in extending direct supervision by a EU Authority to other players/areas, although such a decision should be taken on a case-by-case basis and should be subject to public consultation.

Mediation and arbitration

In addition to the new legally binding mediation mechanism between national supervisors and the new legally binding technical level 3 interpretation that will be issued by the future Authorities, EFAMA members would welcome a **legally binding arbitration mechanism** covering disputes between an individual firm and its national supervisor. Such disputes should include diverging views between a national supervisor and an individual firm on national interpretation of an EU Directive. We call on the Commission to investigate this issue further.

Accountability

EFAMA members agree with the Group's view that governance and accountability of the three future Authorities will be crucial, and that the **right balance** must be found between **accountability** on the one hand and a **high degree of independence** on the other.

Timing

Although EFAMA members believe that a new European supervisory architecture should be introduced sooner rather than later and that the European Commission should use the political momentum to make substantial progress, the quality of the structure and expertise should not be given up at the expense of speed. Therefore, we believe that the **two-step approach** proposed by the de Larosière Group **is sensible** and might guarantee that the interests of all stakeholders are taken into account and that "easy wins" such as reinforced resources for the Level 3 Committees might be realised at an early stage.

Reviewing the ESFS

EFAMA members have strong reservations regarding recommendation 22 whereby the future supervisory system could move towards a system which would only rely on two Authorities. We are not in a position to judge on the advisability of establishing a single Authority for the banking and the insurance sectors, but we believe that **the securities sector should continue to be supervised by a separate authority** responsible for both prudential supervision and

conduct of business issues. Moreover, questioning the major features of the envisaged reform even before it has been put into effect does not appear to be the right course of action.

Regulation and supervision at international level

EFAMA members call on the European Commission and Member States to work towards a **strong European representation in international bodies and organisations** in order to enable Europe to shape the future international regulatory and supervisory framework.

In addition, we regret that the de Larosière report focuses almost exclusively on international bodies such as the Financial Stability Forum or the Basel Committee, i.e. bodies with a strong banking perspective, and ignoring the **important role of IOSCO** in promoting convergence of international financial regulation and supervision in the securities sector.

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