

Reviewing European retail investment regulation, Solvency II, and financial stability

Summary

- The Commission ran an open hearing on retail investment products in July, in which a number of UK stakeholders participated including the FSA and major corporates.
- This briefing also contains a summary of global financial stability activity by various European and international bodies, as well as updates on Solvency II, mortgages, and retail investment products.

This briefing updates on recent developments in Europe and internationally, namely:

- A review and possible consolidation of European regulation on retail investment products; and
- UK and international responses on the global financial crisis

Reviewing retail investment regulation

The European Commission organised a public hearing on retail investment products on 15 July. The purpose of this was to bring together various perspectives in response to the Commission's recent call for evidence on harmonising regulation governing retail investments.

The day-long event comprised a series of speaker panels representing various stakeholders including investment companies, brokers, consumer groups, and national regulators, and was chaired by David Wright, Deputy DG of Internal Market of the European Commission. British speakers came from the Investment Company Institute, Fidelity Investments, the Financial Inclusion Centre, and the FSA (Dan Waters). The event discussed three broad areas:

Product disclosure and investor protection: there was considerable debate particularly among consumer speakers as well as brokers. Competition for access between various distribution channels (be they IFAs in the UK or bancassurers on continent) is complex and opaque, partly due to disclosure issue. However there is no firm answer or formula at improving disclosure.

Combating regulatory arbitrage: the process whereby people chose certain types of products to avoid types of regulation is still prevalent in the retail investment space. Unit-linked wrappers to avoid MiFID rules for example. There might be scope for high-level disclosure requirements. While tax incentives might not encourage people to save, they certainly do the flow of savings between different classes of products.

Differing regulatory structures: there is a seeming plethora of different regulatory treatments across different types of products, all with massively different regulatory treatments on constitution, capital requirements, oversight, etc. This is immediately apparent in a comparison between, for example, UCITS, unit-linked life insurance products, structured notes, bank term deposits (see box below).

There are also still cross-border issues. There was a strong debate, particularly between the Dan Waters of the FSA and the Commission that there is in fact a limited cross-border market in things like UCITS,

Why is this dialogue so important to CII members?

- Many UK regulatory developments such as ICOB have their origins in European processes to create a single-market in financial services;
- Many EC initiatives develop into legislation that has far-reaching implications on UK industry, eg MiFID. Once passed in Brussels, the FSA must implement in the UK and no amount of lobbying can change that;
- Therefore any views on overall Commission thinking on this subject must be voiced at this early stage.
- This initiative on “retail investment products” could cut across work by the FSA on RDR. Many of the same issues are being discussed.

therefore best left to national level to resolve issues in initiatives such as the Retail Distribution Review.

	UCITS funds	Unit-linked life insurance products	Structured notes	Bank term deposits
Product constitution	UCITS Directive	Life Directive	No rules at EU level	No rules at EU level
Capital requirement	UCITS Directive	Solvency I (to be replaced by Solvency II)	Capital Requirements Directive	Capital Requirements Directive
Independent oversight	Depository of UCITS Directive	None at the insurance company level	No rules at EU level	No rules at EU level
Rules for disclosure to investors	Simplified Prospectus of UCITS Directive	Life Directive	Prospectus Directive	No rules at EU level
	Simplified Prospectus of UCITS Directive	Life Directive	Prospectus Directive	
	MiFID for high-level types of disclosure requirements	Insurance Mediation Directive for some disclosure requirements	MiFID for high-level types of disclosure requirements	
	E-commerce Directive or Distance Marketing Directive			
Rules for selling	MiFID	Insurance Mediation Directive	MiFID	No rules at EU level
	UCITS Directive			
	E-commerce Directive or Distance Marketing Directive			

The Commission will review this issue and produce a report of next steps by the end of the year. Many findings are already feeding into the current work on the new Undertakings for Collective Investment in Transferable Securities (UCITS) Directive covering open-ended collective investment schemes. This Directive is being re-drafted this autumn.

EU Roadmap on Financial Stability

- improving transparency in the financial services market;
- enhancing financial reporting requirements and the powers of regulators to call for information;
- strengthening prudential rules in the banking sector, including changes to the Capital Requirements Directive that applies to the banking sector that came into force in January 2007; and
- investigating structural market issues such as the roles of credit ratings agencies.

Global Financial Stability

The global financial crisis over the last few weeks and months has led to significant action at the EU as well as national levels.

- The French government in its role in the current EU Presidency published a detailed report in early September on the financial crisis (the report came out only a few days before the Lehman collapse). Its 30 recommendations are mainly around creating ways of hot-wiring decision making, increasing debate at political level, regularly reviewing financial services policy.¹
- The EU themselves has stepped up its actions at the European level. Shortly after the Northern Rock crisis, EU finance ministers agreed in October 2007 a Roadmap which included the following provisions.
- The Financial Stability Forum (FSF) presented to Finance Ministers in April a five-point plan on strengthening prudential oversight of capital, liquidity and risk management. The FSF was established by the G7 in 1999 to improve regulator cooperation in market supervision and surveillance. Their proposals were largely in line with the EU "Roadmap" and the G7 asked the FSF to review such actions at around the same time as the EU meeting mentioned above.²

Solvency II Update

The FSA published on 25 September a Discussion Paper on Insurance Risk Management, representing the start of its Solvency II preparation programme for the UK insurance market.³ The paper:

- highlights and explains key aspects of the UK regime and identifies actions that insurers should be undertaking; and
- consults stakeholders for comments on ways the FSA could help (22 questions with responses by 31 Dec 2008).

Industry stakeholders are lobbying the French Presidency to push strongly towards a timely adoption of the Directive through its term.⁴ There was some disagreement amongst some stakeholders in the recent Quantitative Impact Assessment (QIS) 4 process on the calibration of equity risks, particularly around the rules applicable to pension funds.⁵ Under the QIS4 process managed by the Committee of

¹ *Report on the Financial Crisis: In the Context of the 2008 French Presidency of the EU*, République française, Sep 2008, 99pp. Copy available from Policy & Public Affairs Team.

² Financial Stability Forum press release, "Financial Stability Forum recommends actions to enhance market and institutional resilience," 11 April 2008. <http://www.fsforum.org/home/home.html>

³ FSA DP08/4 *Insurance Risk Management: The Path to Solvency II*, Sep 2008, http://www.fsa.gov.uk/pages/Library/Policy/DP/2008/08_04.shtml See also FSA launches Solvency II advice paper," by Scott Vincent, *Insurance Day*, 25 Sep 2008.

⁴ See "Solvency II: act now or you'll regret it," by Annette Olesen, *Insurance Day*, 27 Aug 2008.

⁵ See for example, ABI "Solvency II Bulletin," Issue 8, May 2008 http://www.abi.org.uk/Document_Vault/SolvIIIssue_8.pdf

European Insurance and Occupational Pensions Supervisors (CEIOPS), insurance groups had until end-July to submit a return.

Axa issued a statement that the “failure to solve these issues in a timely manner would put at risk most of Solvency II’s benefits” and said the timetable towards meeting the 2012 implementation was now “very uncertain.”⁶ The French presidency began on 1 July, and 11 June saw the deadline for amendments in the European Parliament for the Level 1 Directive, with a view to getting a vote next month.

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⁶ “French presidency must push on Solvency II plan,” *Insurance Day* 24 June 2008.